DOCUMENT RESUME

ED 281 927 UD 025 476

AUTHOR	Beltran, Celestino M.; And Others
TITLE	Minority Business Participation in Public/Private Partnerships: A Manual on Joint Development. Final Report.
INSTITUTION	Comprehensive Technologies International, Inc., Fairfax, VA.
SPONS AGENCY	Department of Transportation, Washington, D.C.
REPORT NO	DOT-I-86-14
PUB DATE	Feb 86
NOTE	273p.; Distributed in cooperation with Technology Sharing Program, U.S. Department of Transportation.
PUB TYPE	Guides - General (050)
EDRS PRICE	MF01/PC11 Plus Postage.
DESCRIPTORS	*Business; *Community Development; Development; Disadvantaged; Entrepreneurship; *Minority Groups; *Urban Improvement
IDENTIFIERS	*Public Private Relationship; Public Transportation; Self Employment

ABSTRACT

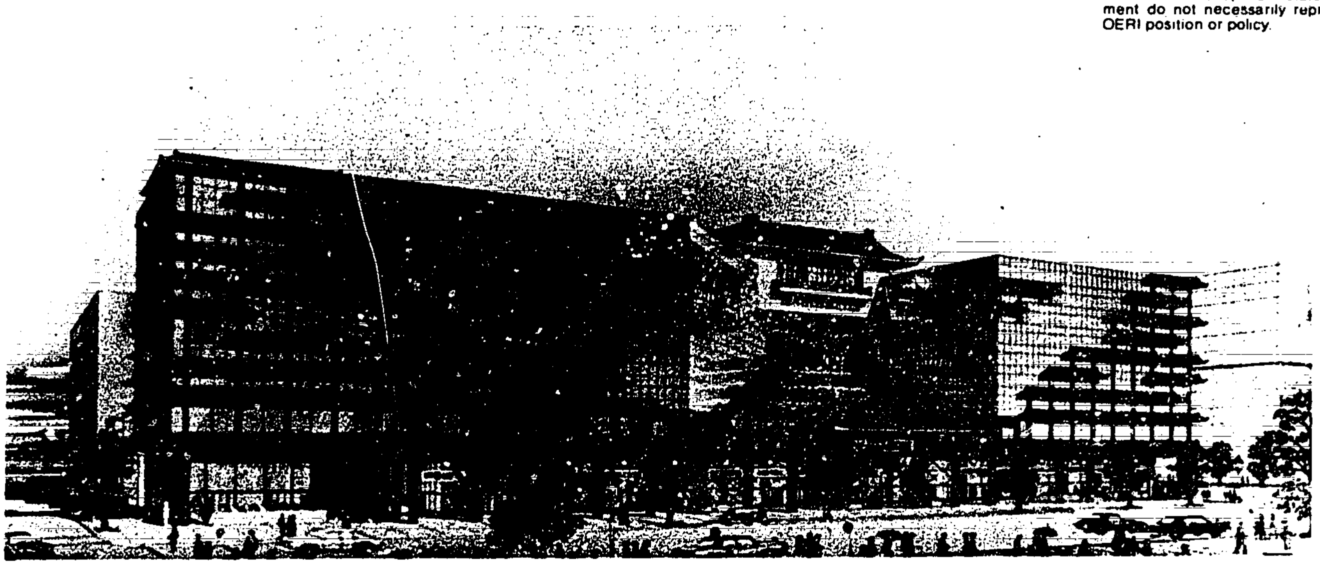
The Urban Mass Transportation Association promotes commercial real estate development projects in and adjacent to transit facilities as a means of generating additional revenues to defray part of local transit agency operating cost. Transit-related real estate development, or joint development, provides unique financial benefits for investors and equity owners, whether for the public or private sectors. Disadvantaged business entrepreneurs (DBEs), defined as minority- and women-owned firms and minority/women entrepreneurs, have not participated as fully as possible in the equity ownership opportunities offered by joint development projects. This manual attempts to encourage participation by introducing DBEs to the benefits and risks of commercial real estate development and the specific requirements of joint development projects. A self-teaching guide, it describes the unique characteristics of joint development projects, explaining in detail the underlying process, with special attention paid to participant roles and policies. It provides a basic introduction to financial planning so DBEs can evaluate their financial readiness to pursue equity ownership opportunities in joint development projects. The manual provides an analytical framework in which to apply the technical tools commonly used in analyzing a transit-related real estate investment opportunity. The appendixes include case studies highlighting key issues associated with joint development projects, a list of sources of information on commercial real estate, an example of a local transit agency prospectus, a personal financial profile questionnaire, a glossary of terms, and a bibliography. (Author/LHW)

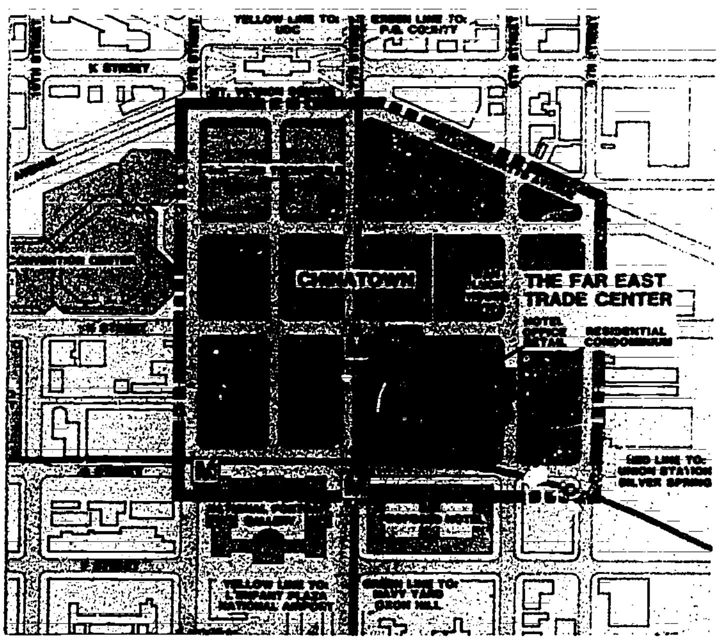
3-27-87

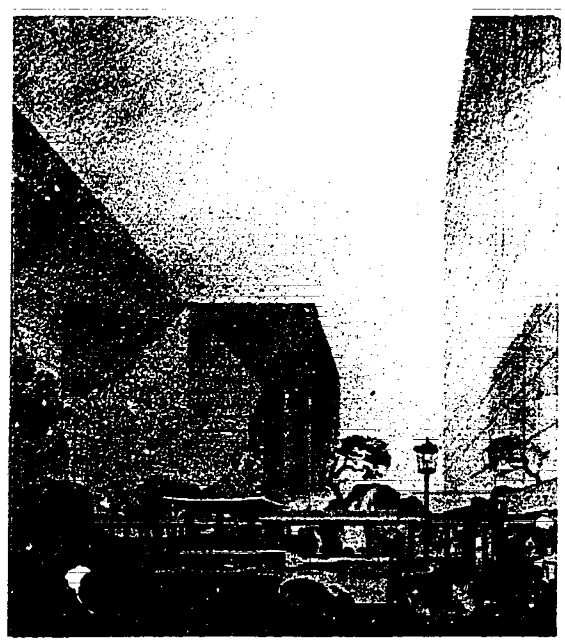
U.S. Department of Transportation

Minority Business Participation in Public/Private Partnerships: A Manual on Joint Development

February 1986







DESCRIPTION OF DOCUMENT COVER PHOTOGRAPHS

The photographs on this Document Cover are a graphic design presentation of the proposed FAR EAST TRADE CENTER joint development project at the Gallery Place North Metro Station in Washington, D.C. These graphic designs were developed by Alfred H. Liu, A.I.A. and AEPA (Architects Engineers, a Profesisonal Corporation) and are copyrighted materials. Mr. Liu has authorized the reproduction of these graphic designs in this document. Any inquiries about further use or reproduction of these materials must be directed to the copyright holder (i.e. Alfred H. Lui (202) 822-8320).

Minority Business Participation in Public/ Private Partnerships:
A Manual on Joint Development

Final Report
February 1986

Prepared by
Celestino M. Beltran, Peter M. Theobald,
Fernando Milan, and Anthony Gomes
Comprehensive Technologies International, Inc.
4260B Chain Bridge Rd.
Fairfax, Virginia 22030

Prepared for
Office of Grants Management
Urban Mass Transportation Administration
U.S. Department of Transportation
Washington, D.C. 20590

Distributed in Cooperation with
Technology Sharing Program
Office of the Secretary of Transportation

DOT-I-86-14

ACKNOWLEDGEMENTS

The design, development and production of this manual required the assistance of both public and private sector resources and individuals. In particular, CTI would like to recognize the contributions of several individuals to this effort.

First, Mr. Wallace Katz of UMTA's Office of Grants Management was assigned to monitor this project. His participation was essential. His guidance and review of all drafts of this document proved most beneficial in assisting CTI narrow the focus and emphasis of the manual.

Second, special thanks are in order for Mr. John Green and Mr. Lee Sillman from the Office of Planning at the Washington Metropolitan Area Transportation Authority (WMATA). Both gentlemen graciously provided CTI staff with extensive information on the problems and issues underlying the evolution of WMATA's joint development program. They spent hours explaining the complexities of transit planning and the role of transit agencies in joint development ventures. Their technical review of the final drafts helped to clarify public/private development issues.

Third, as part of the research for this project, CTI interviewed several antrepreneurs and developers who have attempted to participate as equity owners in joint development projects throughout the country. Their willingness to share their positive and negative experiences in joint development provided an invaluable source of data for the project. Their "lessons learned" were incorporated throughout the manual.

In closing, CTI would like to give due recognition to its own staff for their untiring efforts to produce a document which will "make a difference". Too often, major socio-economic issues are studied and re-studied without practical applicaton. CTI has strived to make this manual a practical approach to evaluating participation in transit-related real estate investments. The following CTI staff contributed to the design and production of this manual.

Celestino M. Beltran
Project Manager/Writer

Peter M. Theobald
Senior Researcher

Fernando Milan
Senior Researcher/Writer

Anthony Gomes
Researcher

Mary Cary
Production Typist

Ava Flores
Production Typist

Marta L. Valldejuli
Production Supervisor

DISCLAIMER

The information provided in this document is the sole responsibility of CTI and does not necessarily represent the policies of UMTA. CTI takes all responsibility for errors and omissions pertaining to this document.

TABLE OF CONTENTS

PAGE

PAGE

PREFACE

The Urban Mass Transportation Administration (UMTA) is a division of the U.S. Department of Transportation responsible for assisting urban centers modernize and expand their public transit systems. Due to the limitations on Federal financial resources, UMTA has encouraged local transit agencies to design innovative programs which foster private sector financial participation in transit system developments. One such initiative is the promotion of commercial real estate development projects in and adjacent to transit facilities, as a means of generating additional revenues to defray part of local transit agency operating cost. Transit-related real estate development, or joint development, provides unique financial benefits for investors and equity owners, whether from the public or private sectors.

Two critical premises underlying the equity ownership opportunities of joint development projects guided the preparation of this manual.

First, joint development projects yield financial and social benefits to both the public and private sectors. For the public sector, joint development projects generate an income stream to supplement the financial resources necessary to maintain and operate mass transit systems; they also help to revitalize the physical environment around a transit station, stimulating neighborhood and urban redevelopment. For the private sector, joint development projects offer the opportunity to integrate commercial real estate development projects into the public transit infrastructure system therefore reducing risks and uncertainty while increasing financial returns over the long term.

Second, disadvantaged business enterprises (DBEs), defined as minority and women owned firms and minority/women entrepreneurs, have not participated as fully as possible in the <u>equity ownership</u> opportunities offered by joint development projects. In part, this fact stems from DBEs' lack of awareness regarding the equity opportunities available, and their lack of knowledge of the transit-related real estate development process. Additionally, public and private sector decision-makers often assume minorities and/or women are unable to participate as

equity owners because they are not knowledgeable about the financial and technical aspects (i.e. financial packaging, syndications, legal, development management, leasing, etc.) of multi-million dollar transit-related real estate development projects. This elitist attitude creates an adverse environment in which local minority communities feel disenfranchised from the urban revitalization which their tax dollars support. Even more important, they are excluded from the opportunity to be entrepreneurs within the American free enterprise system.

This situation is unnecessary. Local transit agencies can cease to support unwritten policies which relegate DBEs' joint development equity ownership participation to weak and uncertain local market areas, or which offer DBEs only token equity participation in the financial opportunities of joint development projects. Local transit agencies have the capacity and the responsibility to pursue policies with DBE's, private sector developers, and lending institutions which establish and accept DBEs as equal equity partners in rebuilding the Nation's cities. To achieve this partnership, between DBEs and local transit agencies, DBEs must also accept responsibility for learning about transit-related real estate development opportunities. DBEs must learn about joint development if they want to participate in the process. They must also know about the financial analysis of transit-related real estate development opportunities.

Most important, DBEs must develop their own pools of equity capital by exploring creative ways and techniques for attracting investment capital from the minority/ women's business community and the minority community in general. They must derive strategies for educating and encouraging minority communities to invest a portion of their income in long term wealth creating real estate investments. As a beginning, well established DBE developers and investors should concern methods for pooling their financial and technical resources in pursuing joint development opportunities. The success of such endeavors will provide the credibility to attract minority and non-minority capital.

Public and private sector cooperation is also critical in maximizing DBE equity ownership. The public sector must establish policies which actively encourage and solicit the participation of DBEs in all forms of equity ownership, be it as owners/developers or limited investors. These public policies must be implemented and monitored through strategies which insure that DBEs can access the long-term financial benefits of transit-related real estate development projects.

The private sector must also overcome the stereotyped perception that DBE equity partners are a burden or liability. Rather, DBE involvement in joint development projects can offer majority developers added managerial experience and solid financial resources; experienced DBE developers are available and minority investors have money which is as good as

anyone's. And, minority participation in joint developments can leverage political support from the minority community for well conceived transit projects.

The primary purpose of this manual, then, is to promote increased equity ownership participation by DBEs in transit-related real estate development. Its method is to introduce DBEs to the benefits and risks of commercial real estate development and the specific requirements of joint development projects.

Designed as a self-teaching guide, the manual describes the unique characteristics of joint development projects. The process underlying joint development is explained in detail with special attention paid to participant roles and policies. The manual also provides the reader with a basic introduction to personal financial planning, so each interested DBE can evaluate his/her financial readiness to pursue equity ownership opportunities in joint development projects. The manual provides the reader with an analytical framework in which to apply the technical tools commonly used in analyzing a transit-related real estate investment opportunity. Case studies will also be presented to highlight some of the key issues associated with the unique aspects of joint development projects.

The manual should be useful to:

1. DBEs interested in transit-related real estate investment opportunities.

2. DBE developers and investors interested in ownership and business opportunities associated with public mass transit projects.

3. Local transit agency divisions whose responsibility it is to assist in the identification and promotion of minority business opportunities.

4. Developers and lending institutions interested in joint development ventures with DBEs in transit-related real estate opportunities.

CHAPTER ONE

LAND DEVELOPMENT AND OWNERSHIP OPPORTUNITIES IN TRANSIT-RELATED REAL ESTATE DEVELOPMENT PROJECTS

OVERVIEW

The purpose of this chapter is to introduce DBEs tc the concept of transit-related real estate development (i.e. joint development). Emphasis is placed on understanding joint development as a real estate product and a public policy process. The financial benefits of equity ownership in joint development projects are stressed. The chapter concludes with a discussion of the traditional barriers limiting effective DBE equity participation in joint development opportunities.

I. WHAT IS JOINT DEVELOPMENT?

Joint development refers to the planning and implementation of an income producing real estate development which is adjacent to or physically related to an existing or proposed public transportation facility (e.g. Metrorail transit station, Kiss & Ride Facility, bus transfer facility, etc.). Joint development can take a variety of forms. A joint development project may involve a multi-level commercial complex consisting of retail, entertainment, housing and office space integrated with a rapid transit facility. In other cases, a joint development project may involve a commercial complex built over the air rights of a transit facility.

Several important elements of the above definition should be noted by DBEs new to transit-related real estate development. First, joint development is a unique form of real estate development, in that public transportation investments are integrated with private land development investments. In most joint development ventures both the private and public sector participants share in the costs and financial benefits. Private sector participants are concerned with issues of financial feasibility and return on private investments. Public sector participants, in addition to financial returns, are also concerned with matters such as increased ridership, expanded job opportunities, broadened tax bases and physically attractive and highly utilized station areas.

Second, joint development projects require a high degree of cooperation amongst public sector agencies and between these agencies and private sector participants. Unlike conventional real estate development where there is usually an "arms length" relationship between the public and private sector, joint development requires the active participation of both. In joint development ventures the public sector is an active participant, assuming some of the costs, risks and benefits inherent in a specific project development. The degree of public and private sector cooperation varies from project to project depending on the functional, financial and legal arrangements entered into by the various participants. Regardless of the level of cooperation involved, joint development projects come into being only after the separate concerns and objectives of each participant are acknowledged and negotiated around some common ground.

Third, and perhaps most important to DBEs new to real estate investments, the public character of joint development projects does not obviate private real estate standards of financial feasibility. Although the public sector may share in some of the costs and provide financial and non-financial incentives, the feasibility of any joint development venture is mostly determined by market forces. DBEs and minority entrepreneurs interested in joint development ventures must evaluate those market forces carefully for they not only

determine the use of a specific project site, but also its overall success.

II. EXAMPLES OF DBE EQUITY PARTICIPATION IN JOINT DEVELOPMENT

Although examples of DBE equity ownership in joint development projects are few, some examples do exist in various stages of completion. These DBE joint development efforts vary by type of public sector arrangement and private sector equity agreement. Nevertheless, these projects are designed to combine public/private resources to increase transit ridership, augment revenues to the public sector and provide a reasonable return on investment to the private sector participants. Among these examples of DBE equity ownership in joint development projects are:

- **EXAMPLE A**

In this particular joint development project, the local transit agency owned and controlled the development site directly above a downtown underground metrorail transit station. In preparing the request for proposal (RFP) for this development site, the transit agency included in the bid specifications the policies of the Board of Directors regarding DBE participation in joint development projects. One element of the DBE plan required a goal of fifteen (15%) percent participation by minorities/women in the equity ownership of development projects.

One of the city's most successful non-minority developers, in an attempt to comply with these DBE goals, approached five minority attorneys to seek their participation as general partners in responding to this upcoming solicitation. An agreement was reached in which the attorneys initially received twenty-five (25%) percent of the equity on the project for their professional services and risk capital contributions. As for the developer, he received 25% equity, development fees and management fees. The remaining 50% equity was syndicated for capital contribution from limited partners. The proposal was developed and submitted by the developer. The general partnership was successful in obtaining the "development rights" to the site. The transit agency was guaranteed four (4) percent of the project's effective gross income.

Twenty-two (22) months later, the vacant joint development site was transformed into 110,000 s.f. of commercial office space, 46,000 s.f. of retail space and 80,000 s.f. of parking. Unable to meet the additional calls for cash during the leasing up period, the attorneys ended up with twelve (12%) percent of the equity and the developer (meeting his cash call contributions along with those of the attorneys' portions) ended up with 38% of the equity.

- **EXAMPLE B**

The local redevelopment authority of the city owned the joint development site above an underground metrorail transit station near downtown. The property was purchased with public monies (i.e. Federal urban renewal funds), which allowed the city to require the local redevelopment authority to include a thirty (30%) percent participation by DBE investors in equity ownership of the proposed joint development project.

A minority developer experienced in commercial/retail buildings under two million dollars joined his talents with three minority investors. Together, they solicited the participation of one of the city's major non-minority developers to pursue the "development rights" to this particular development site. In their agreement, the minority partners provided all the risk capital and equity capital contributions for 75% equity in the project. The non-minority developer provided all construction phase guarantees and operational deficit guarantees for a development fee, management fee and 25% equity in the project.

This development entity* was successful in obtaining the "development rights" to the site. The local redevelopment authority was guaranteed three (3) percent of the effective gross income. Twenty-four (24) months later,

* Refer to Chapter I, Section IV for a complete definition of "development entity".

the site possessed a 350 room hotel and 55,000 s.f. of retail space and 94,000 s.f. of parking. The general partnership equity arrangements remained unchanged. The local redevelopment authority received all land tax increments above the city appraiser's valuation of the project site.

- **EXAMPLE C**

This joint development project emerged from local transit agency development policies which actively promoted the use of transit-related real estate development to stimulate economic growth in weak and uncertain local markets. To this end, the local transit agency identified community based non-profit community development corporations (CDC) to act as the transit agency's private sector partner in the development of selected joint development projects in weak local markets.

One local CDC was given a grant of $150,000 to prepare a development proposal for the site. The CDC joint ventured with an experienced minority developer. In their joint venture agreement, the CDC would contribute $6,000,000 of equity capital from local, state, and Federal grant and loan programs and receive 80% equity ownership of the project. The minority developer was to provide all construction and operational deficit guarantees in the first two years of operation in exchange for a development fee, management fee and 20% equity ownership of the project.

The development plan for the site called for 110,000 s.f. of commercial office space, 60,000 s.f. of retail space and 250,000 s.f. of parking (kiss and ride). The local transit agency approved the development plan. Twenty-four (24) months later the project was built. The transit agency receives five (5%) percent of the net cash flow from the commercial facilities and seventy-five (75%) percent of the net cash flow from the commuter parking facility.

III. FRAMEWORK FOR JOINT DEVELOPMENT

From the above examples of DBE equity ownership in joint development, it is apparent that there are a variety of ways for DBEs to access equity opportunities. It should also be noted that these equity opportunities were not created in a vacuum. Rather, these opportunities were the direct result of public policies and specific implementation plans which promoted DBE equity participation and private sector real estate investment decisions which were responsive to local market conditions. In order to place these public and private sector dimensions of joint development into a workable framework for analysis, DBEs are encouraged to examine joint development from two distinct but complementary perspectives: joint development as a "process" and, joint development as a "product".

As a "process", joint development requires a high degree of coordination and cooperation between the public and private sector. UMTA's Office of Grants' Management defines joint development as:

> A process through which public transportation investments are coordinated with private land development investments so that they will generate a maximum stimulus to economic development and urban revitalization. Joint development occurs when the public and private sectors work cooperatively in the planning, financing and construction of development projects adjacent to and integrated with transportation facilities.

Joint development involves fundamental issues of property rights, jurisdictional boundaries and the interplay of market forces on investment decisions and incentives needed to attract the private sector's participation. In the language of joint development, planning and development policies encompass all those pre-development activities and decisions of a local transit agency or other public agencies necessary in "packaging" a joint development opportunity for private sector participation. These pre-development activities provide the deal-making environment in which the public/private sector participants will enter into formal financial and legal agreements. Chapter II is dedicated to a detailed discussion of joint development as a "process".

The second perspective examines joint development as an investment leading to a real estate "product". According to this perspective, joint development is essentially an income producing real estate investment which is physically and functionally integrated with a public transportation facility. Such integration is designed to maximize the economic returns of the project to both public and private sector participants.

Transit-related real estate development projects are undertaken when private sector participants are convinced that a reasonable rate of return on their investment is feasible. A transportation facility can change the specific market condition for a particul : joint development venture by improving the potential uses and economic returns of the venture. However, the transportation component, in and of itself, can in no way substitute for the intrinsic marketability of a proposed project. This point is particularly important when one considers that most transit systems have been traditionally designed to transport people rather than maximize the economic development opportunities at each station or stop. The underlying investment considerations of joint development as a product are discussed in detail in Chapter III.

The importance of viewing joint development as both a process and a product is beneficial in formulating DBE strategies. In attempting to work with the local transit agency, DBEs must be aware that they are dealing with decision-makers whose policies must be responsive to local political and fiscal priorities. Consequently, DBE strategies designed to improve and secure access to DBE equity ownership opportunities must recognize and address these political realities.

Similarly, when addressing the product dimension of joint development, DBEs must be sensitive to those factors which lead to making prudent real estate investment decisions. DBE strategies for pursuing equity ownership opportunities must address the financial impact of decisions both on DBEs and their partners.

IV. BENEFITS OF DBE EQUITY PARTICIPATION IN JOINT DEVELOPMENT PROJECTS

Equity participation in transit-related real estate development projects is very much like owning part of a business. In the early years of the business venture, various tax deductions, tax credits and operating losses are created in excess of income by the business. Owners/investors can apply their share of these losses against their own income, thus lowering their tax bill. As the real estate venture develops, and as it becomes successful, the owners/investors are entitled to a share of the profits. In most cases, this income is partially or fully sheltered. Since tax benefits of real estate projects are greatest in the initial years of ownership, this tax-favored benefit is reduced over time. Then, generally the real estate projec: is refinanced or sold and the net proceeds distributed to the owners/investors.

Before expanding on the benefits of equity ownership in joint development projects, let us examine the definition of "owners/investors" in a real estate development venture. The

owners/investors of a real estate project are directly responsible for the management and day-to-day decision-making on the project and are commonly referred to as the "development entity". In most commercial income producing real estate development ventures, this development entity consists of a developer* or a developer and a group of initial joint venture investors.

Since this manual is primarily directed to DBEs interested in participation as active equity owners in the management of transit-related real estate development projects, a DBE Development Entity is defined as follows:

> A DBE Development Entity** is the <u>initial</u> group of minority and/or women entrepreneurs and/or small business firms owned and controlled by minorities or women who <u>combine</u> their managerial and financial resources into a <u>legal entity</u> to pursue the "development rights" and ownership of a joint development opportunity with the stated intention of earning a <u>profit</u> and retaining an <u>equity interest</u> in the project.

This definition is in accord with the definition of a DBE set forth in U.S. Department of Transportation regulations under 49 CFR Part 23. However, this definition of a DBE development entity does not imply or suggest that DBEs restrict participation in an equity ownership opportunity to only DBEs. Rather, it is imperative that DBEs formulate a strategy for organizing a development entity which complements the resources and capabilities of DBEs with the talents and experiences of non-DBE developers, consultants and investors.

---

* The developer is the lead person in the development entity who conceptualizes the project, organizes, coordinates and supervises the sources of capital, labor, and material throughout each phase of the project from beginning to end. The developer normally is an equity participant in the development entity but not necessarily. Irrespective of the developer's equity position in the development entity, he/she will usually expect to earn fees in addition to their equity return.

** Community based non-profit community development corporations(CDC) can and do play the role of the "DBE development entity" in joint development projects. The major difference between a CDC and a conventional business/entrepreneur is that the CDC must reinvest its profits back into the community's economy whereas a business/entrepreneur's profit has unrestricted use.

DBEs have a variety of participation options in a development entity. First, a DBE, based on his professional experience, may choose to be the developer or general partner responsible for initiating, organizing, and managing the project. Second, a DBE may choose to be a limited partner, i.e. an initial investor in the project who hopes to receive a higher return on his/her investment but chooses to limit his/her participation in the management and liability of the project. Third, a DBE may choose to reduce his/her financial risk in the project and therefore reduce his/her financial return by waiting to invest in the project until the project is underway (i.e. another form of limited partner). Each DBE participant in the development entity must decide which role best suits his or her managerial skills and personal financial objectives (refer to Chapter Three).

A. Financial Benefits

Since transit-related real estate development involves income producing commercial projects, there are financial benefits that can accrue to a DBE "development entity" and its investors. In general, the financial benefits accrue to the equity owners by maximizing income from the following sources. These sources are:

- **Cash Flow** - The income generated after cash expenses and debt service have been paid out.
- **Tax Benefits** - The sheltering of otherwise taxable income. Tax benefits are generated through depreciation or payment of interest on debt.
- **Appreciation** - The increase in the market value of a property, which is largely attributable to increases in cash flow resulting from increases in rents or other sources of income.
- **Equity Build-Up** - The gradual increase in equity as the mortgage on the property is paid off.
- **Development/Management Fees** - These fees are normally paid to the member or members of the "development entity" who are responsible for managing the project from concept, design, financing, construction, and during the operation of the project. The amount of these fees is negotiable among the participants.

A fundamental quality of the financial benefits generated by income-producing properties (such as joint development projects) is that not all the benefits accrue at the same time nor in the same proportion to members of a DBE development entity. In part, the level of benefits accruing to members of a

development entity depends on their level of financial contribution, financial benefit structure, and the ownership structure of a project.

With the exception of development/management fees, non-project managing investors (i.e. limited partners) also obtain financial benefits in the form of cash flow, tax benefits, appreciation and equity build-up. Again, the level of these benefits depends on the level of financial contribution, financial benefit structure and ownership structure of a project.

B. Reduction in Financial Risk

Equity ownership in any real estate project is a business decision to maximize investment relative to risk. It is this aspect of "risk reduction" which identifies transit-related real estate development as a unique opportunity for DBEs. Joint development offers a singular benefit in that the local transit agency accepts the initial business risk of preparing the joint development site for equity participation. Under ideal circumstances, a local transit agency (1) identifies the site; (2) acquires control of the "development rights" to the site; (3) undertakes special studies to determine the marketability of the site; (4) coordinates, to the extent possible, any zoning requirements and obtains public approval for the site; and (5) provides financial and non-financial incentives to attract potential developers and investors to develop the site.

In other words, the local transit agency is offering the DBE development entity a "packaged real estate investment opportunity". His or her level of initial financial risk is reduced. The developer is not required to invest "risk capital"* during this pre-development phase. All of these pre-development activities take considerable amounts of money and time which represent a cost savings to DBEs in the form of reduced uncertainty and reduced financial risk. It is, however, the developer's task to evaluate the results of the pre-development activities undertaken by the local transit agency. If, based on this evaluation, the DBE development entity is satisfied that there is a reasonable financial opportunity, it is at this time (and not before) that the DBE development entity must expend their "risk capital" to prepare a competitive proposal to comply with the criteria set forth in the transit agency RFP.

Other unique risk reduction benefits are the incentives which the transit property provides to increase a development

---

* Risk Capital is defined as the money needed to bring a project concept to the point where institutional lenders and other investors are prepared to invest their financial resources to construct the project. Prior to this point, the initial development entity has no guarantee that the project will obtain financing.

entity's chances for market success. Several types of risk reducing incentives can be employed by a public sector agency depending on prevailing market conditions -- strong, uncertain, weak -- and the overall purpose of a project. In a strong market, public sector incentives might not be needed. To the extent they are provided, such incentives might be limited to assistance with land assembly or the provision of special zoning designed to increase the amount of rentable space in a project.

A joint development project undertaken in what is considered a weak market may call for more direct public sector financial involvement. In such cases, a public sector agency may provide incentives which substantially reduce the risks and costs associated with a project, and which may facilitate lender financing. Among the types of public sector incentives applicable in a weak market situation are land writedown, tax exemptions and graduated leasing arrangements.

Although most local transit agencies establish procedures for evaluating joint development proposals well in advance, some incentives deemed necessary for project feasibility can be negotiated. It is important that such incentives be recognized early in the process and negotiated prior to the issuance of a prospectus by a local transit agency.*

C. Management Participation/Control

Equity ownership in joint development ventures allows a DBE development entity to participate in the management and decision-making of the project during planning, constructing and operation. This type of participatory equity ownership in transit-related real estate development projects allows DBEs to exert influence as to who gets the most lucrative and prestigious contracts during the planning, design, financing, construction and operation of the project. Minority ownership implies opportunities for other minority businesses.

Heretofore, DBE opportunities in the majority of joint development projects throughout the country have been restricted to the low skill, labor intensive type of subcontracts. There are, however, qualified minority/women professionals in every major U.S. city most capable of being the project attorney, project architect, prime contractors, commercial leasing agent, etc. The propensity to limit DBE participation in transit projects to non-professional business opportunities can only be adequately changed through accessing the private sector decision-making process. The price for this access is equity ownership in the development entity.

*This point cannot be over-emphasized. Attempting to negotiate non-financial and financial incentives after the joint development Request for Proposal (RFP) is published may result in non-compliance with the RFP.

Once DBEs are active participants of the development entity, they are in a position to participate in the management decisions as to who gets hired. In sum, DBE equity participation in joint development ventures can have a multiplier effect beneficial to other DBEs traditionally unable to access premier business opportunities needed to implement a joint development project.

V. BARRIERS TO DBE EQUITY PARTICIPATION IN JOINT DEVELOPMENT

Historically, equity participation by DBEs in joint development has been limited, which means that DBEs have been excluded from participation in an enterprise which offers a prime opportunity for long-term creation of wealth. Many factors account for the low level of DBE equity participation in joint development projects. Among the most common barriers affecting DBE participation in joint development ventures are:

1. Lack of Risk Capital

Despite the fact the local transit agency has incurred all the pre-development cost (i.e. land acquisition, highest and best use studies, etc.) and financial risk, substantial sums of money are still needed for the private sector to properly evaluate and develop a real estate opportunity into an economically feasible project. Since there is no guarantee that the investment of capital in the design of a "development plan" will result in obtaining the "development rights" to a particular joint development site, this investment capital falls under the category of "risk capital". And, it is this lack of risk capital which has been a major obstacle to many DBEs interested in joint development opportunities.

This need not be the case. The pooling of financial resources by DBE developers and investors is possible and an absolute prerequisite in playing the real estate development game. The key is to identify DBEs who can build a capital pool.

Given the magnitude of joint development projects it is not uncommon to have as much as $100,000 to $300,000 tied-up in risk capital. While it is important to have all the commitments from the initial investors secured, all the capital need not be expended at once. Rather, these funds can be spent in progressive steps as the project feasibility is assured. At any time in the evaluation process, when it is determined that the project is not feasible, further commitment of funds can cease. And since this initial risk capital is capitalized as part of a legal business entity, any losses can be passed on to individual investors as tax deductions on their personal income tax.

2. Lack of Equity Capital*

Given the multi-million dollar development costs of joint development projects, there is often a necessity to raise 20% to 30% equity ownership capital to meet the requirements of construction and permanent lenders. Although this is a problem faced by any person involved in transit-related real estate development, it is one which particularly affects DBEs. Minority investors in many instances do not have this level of equity capital and, most important, when they go out to seek additional equity capital they must often give up a substantial portion of ownership to outside investors who have not taken the initial risk.

A solution is to anticipate the equity requirements of potential lenders. Once this has been accomplished, it is useful to identify contingent sources of equity capital. Great care must be exercised to structure ownership participation in such a way that contingency capital is incorporated into the project without substantially diluting DBE ownership position throughout the life of the project.

3. Lack of Experience in Real Estate Development

The lack of a track record in a multi-million dollar real estate development is a barrier difficult to overcome. Having no track record usually means that the DBE lacks knowledge of the unique requirements of joint development projects. However, many outstanding real estate development efforts have been successfully carried out by individuals with little or no previous experience - and usually against great odds.

One viable solution to this lack of experience is to organize a development entity which includes participants with major real estate experience in similar projects. A development entity must have credibility and experience in similar projects if it is to attract the equity investors necessary to meet the financial requirements of long-term lenders. Without this credibility and experience, success is possible but not probable.

4. Lack of Knowledge in the Technical and Legal Aspects of Real Estate Development

Real estate development is not a passive investment. It requires that DBEs commit reasonable amounts of time to learning about new and often highly technical terms and practices which, once mastered, are very useful. Although there is no quick

---

* Equity capital is defined as "cash" derived from an owner's personal assets. This type of capital is used to buy ownership in the project. It is used as "risk" and "operating" capital.

solution for overcoming this barrier some cities have quasi public resources which might be of assistance to DBEs in mastering the technical aspects of real estate development. Among these resources are transit agencies, planning commissions and development council's seminars on the co-development real estate process. Additionally, many private sector businesses and schools specialize in real estate investment and financial planning courses. Identify and use all available resources.

5. Lack of Knowledge About How the Political Process Underlying Joint Development Works

The joint development process can present insurmountable difficulties if DBEs do not understand how transit agency development policies affecting minority/women equity participation are formulated and/or can be modified. Get to know the local transit agency Board of Directors and staff. Read their policies. Participate on task-forces, etc.

6. Lack of Minority Organizations

DBEs lack organizations and spokespersons knowledgeable about transit-related real estate development. Remember that the local transit agency is a public entity responsible to the citizens, and therefore responsive to the local political environment. DBE participation in joint development is a local issue which must be negotiated between the local transit agency and the DBE community. UMTA affirmative action regulations, although clear in their intent, must be "actualized" at the local level. DBE leadership and organization are essential to unite the DBE community on key transit issues. One of the most effective methods for assuring that DBE equity ownership requirements are included in joint development programs is to identify and support key members of the Transit Board of Directors who advocate DBE equity participation.

CHAPTER TWO

JOINT DEVELOPMENT AS A DECISION-MAKING PROCESS

OVERVIEW

The previous chapter introduced the concept of joint development as a form of public/private partnership. A framework for evaluating joint development opportunities was provided, along with an examination of the potential benefits accruing to DBEs as a result of equity participation.

This chapter focuses on joint development as a "process" of discrete decisions by both public and private sector participants, culminating in the establishment of a deal-making environment in which joint development will take place. Particular emphasis is placed on the on-going interrelationship and preconditions necessary for creating workable ground rules for bringing together public and private human and financial resources to implement a joint development project. Although the discussion in this chapter is general in scope, it does provide DBEs with a basic understanding of the underlying issues, objectives and decisions addressed by public and private sector participants throughout the joint development process. The chapter concludes with a discussion of alternative strategies which DBEs can follow to insure reasonable and meaningful participation in transit-related equity ownership opportunities.

I. JOINT DEVELOPMENT AS A PROCESS LEADING TO DEAL-MAKING

The ultimate purpose of any joint development program is to integrate income-producing real estate development ventures into the transit system in such a way that both the public and private sector participants are able to achieve their independent objectives. As a result, the joint development process is dynamic. It involves deal-making, that is, sustained negotiations between public and private sector participants to ensure their mutual objectives are satisfied.

The joint development process emphasizes the following:

- Acknowledgment of the interest and objectives of public and private sector participants.
- Authority for local transit agency representatives to acquire land, control land use and participate in income-producing ventures.
- Authority for local transit agency representatives to negotiate those legal and financial agreements required to "close" the deal.

Taken together these three factors constitute the major elements of successful deal-making necessary for the implementation of joint development.

Deal-making includes all the legal and financial agreements necessary to integrate public and private sector investments on a particular joint development site. The use of the word deal-making is appropriate to public/private co-developments of this type because deal-making implies that both public and private sector participants must be willing to give and take in order for both parties to achieve their individual objectives.

Illustration II.A presents a schematic representation of joint development as a process leading to a deal-making environment in which the public and private participants come to binding agreements on a particular joint development site. The component boxes on the far left of the illustration proceeding from top to bottom (i.e. Public Sector Determinants, Participants, Roles, Goals, Joint Development Objectives and Local Transit Agency Joint Development Site Preparations) describe the collective input of the public sector into establishing a successful planning and development framework (i.e. refer to component box in center of illustration) leading to the creation of a deal-making environment.

Similarly, the component boxes on the far right of the illustration proceeding from top to bottom (i.e. Private Sector Determinants, Participants, Roles, Goals, and Joint Development Objectives) describe the parallel collective considerations which must be addressed by the private sector in establishing a successful planning and development framework (i.e. refer again to component box in center of illustration).

Once the public and private sector agree upon those factors which will establish a successful planning and development framework, the process leading to the selection of a specific developer for a specific site begins.

From this examination of Illustration II.A, the following should be readily apparent:

- Deal-making is the high point of the joint development process. It is at this point that agreements regarding public and private commitments and resources are cemented.

- Public and private sector participants in the joint development process are driven to the deal-making stage as a result of specific objectives and benefits which can be best achieved by working together.

- Successful packaging of joint development ventures depends on those essential preconditions which each of the participants bring to the negotiating table.

All local transit agency joint development programs are different in that they reflect the particular governmental, organizational and political setting in which the local transit agency must operate. For this reason, Illustration II.A is an oversimplified model of the most basic public and private sector components leading to deal-making and joint development project implementation. DBEs should use this model as a guide to understanding the decision-making and organizational structure of their particular local transit agency's joint development program.

Carefully review Illustration II.A. This schematic representation of the joint development process will be referred to throughout the remainder of this chapter.

II. ISSUES, PARTICIPANTS, ROLES AND OBJECTIVES OF THE PUBLIC SECTOR IN JOINT DEVELOPMENT

This is the first of several sections of this chapter which address each component box of Illustration II.A in detail. Keep in mind that the joint development process entails a complex set of variables (i.e. planning, engineering, financial, political, legal, etc.) which must be integrated into planning and development policies to bring about joint development

opportunities. DBEs are strongly encouraged to augment the following description of Illustration II.A with extensive reading on this subject. To this end, refer to the bibliography provided in the Appendix of this manual.

A. Public Sector Transit Issues

Depicted in Illustration II.A are some examples of public sector transit issues:

- Decaying Urban Infrastructure
- Urban Congestion
- Reduced Federal Transit Subsidies
- Public Resistance to Increases in Local Taxes

From the perspective of the local public sector, these and other issues set the parameters and priorities as to how public agencies will use limited public resources to address urban transit problems and concerns. Many cities throughout the country have committed part of their public resources to upgrading existing rapid transit systems and building new systems as a means of reducing urban congestion and revitalizing their urban centers. In spite of this local commitment, however, there is a growing recognition that Federal transit subsidies and current levels of local taxes for transit are insufficient to upgrade, expand, and operate these multi-billion dollar transit systems.

For this reason, local transit agencies have developed a variety of innovative financing mechanisms for supplementing public financial resources with private sector resources.* Joint development is one form of value capture** which can help attract private investments to maximize the income producing potential of selected transit-related real estate development sites and therefore improve the public sector's financial capacity to solve or ameliorate urban transportation problems.

---

*Refer to A Guide to Innovative Financing Mechanisms, Rice Center, Houston, Texas, 1982, DOT-1-82-53 for a complete discussion of the various financial mechanisms used to support mass transportation.
**VALUE CAPTURE is a technical term which describes a generic set of tools or mechanisms that enable public interests to actively share in the economic benefits accruing from implementation of a regional rapid transit system. These benefits may be secured or "captured" directly through negotiated agreements with private sector developers, promotional and retailing interests, and other parties who are sponsoring projects that profit directly from the construction and operation of a rapid transit system.

This "revenue maximizing" aim of the public sector must be kept squarely in mind when DBEs formulate strategies to pursue equity ownership opportunities in joint development projects. DBEs must consider ways in which the local transit agency can effectively address public sector transit issues while still providing DBEs with the opportunity to participate as equity owners in joint development projects.

B. Public Sector Participants, Roles and Goals

In order to successfully undertake transit-related real estate development projects, the local public sector must coordinate, and in some cases modify, the goals and responsibilities of various public agencies which have jurisdiction over aspects of joint development projects. Examples of some of the public entities usually involved in planning and influencing transit-related real estate development goals and policies are:

- Local/regional Governments
- Redevelopment Authorities
- Local Transit Agencies
- Public Works Departments

The public entity most often directly involved in the planning and implementation of joint development projects is the local transit agency. The primary goal of the local transit agency is to build and operate an efficient transit system. Since it is the planning and operation of the transit system which creates joint development opportunities, the local transit agency is always a participant to joint development deal-making.

The role of the local transit agency in joint development deal-making may vary from city to city or from project to project. In most instances, it is the transit agency which takes the lead role in joint development planning and implementation. In other instances, a local transit agency may participate in a joint development project in cooperation with other public agencies (i.e. redevelopment authority, regional government, etc.).

In review of Illustration II.A, some of the key goals of these public entities are complementary while others are not. The important point to be made here is that these diverse goals may lead to conflicting policies and objectives hindering the establishment and implementation of an effective transit-related real estate development program. This can be avoided through proper coordination of goals, policies and objectives with the local transit agency.

C. Public Sector Joint Development Objectives

The public sector through its representative agency or agencies enters joint development deal-making with specific objectives that it seeks to achieve. Shared costs, financial return and public benefits are some of the factors considered by each agency before it attempts to acquire land and undertake the pre-development activities required to prepare a joint development site. Included in the set of objectives important to the public sector are:

- **SHARED FACILITY CONSTRUCTION COSTS** - In many instances where strong market conditions exist, a joint development project affords the public an opportunity to share in the construction cost of a transit facility.
- **ENHANCE REVENUES** - A relevant public sector objective is to increase revenues through property taxes generated by real estate development and sharing in the cash flow produced from the project in the form of graduated lease payments, percentage of Effective Gross Income (EGI) and/or sharing in all losses/profits as an equity owner.
- **INCREASED RIDERSHIP** - Joint development projects increase the use of a site and hence ridership is increased. This results in increased fare box revenues for the transit system.
- **STATION AREA PLANNING AND DESIGN** - This objective refers to the harmonious integration of transit facilities with the design structure of real property development.

These joint development objectives have proven to be feasible if properly integrated into the early planning of route selection and station location. Too often, mass transit systems have been planned in accordance with engineering cost minimization factors, without due consideration of joint development potential. Joint development projects are income-producing real estate ventures whose success depends primarily on location (i.e. local economic market). When joint development is consciously allowed for in transit planning decisions, successful achievement of joint development objectives becomes much easier, and therefore results in a higher quality real estate product of greater financial benefit to the local transit agency.

Before examining how the public sector joint development objectives contribute to the establishment of a successful planning and development framework, let us review the considerations leading to the formulation of "private sector" joint development objectives.

III. ISSUES, PARTICIPANTS, ROLES AND OBJECTIVES OF THE PRIVATE SECTOR IN JOINT DEVELOPMENT

The private sector is attracted to a joint development venture by the opportunity to generate a financial return on investment relative to other competing investments. In other words, the joint development opportunity must provide sufficient incentives and financial return on investment at least equal to and preferably better than non-transit-related real estate development opportunities. In recognition of this fact, the public sector must not only provide financial incentives but must also provide the means for reducing and eliminating barriers to private sector participation in joint development projects. This section examines the private sector's prerequisites for participating in a joint development project.

A. Private Sector Development Issues

Illustration II.A describes factors which deter private developers from undertaking major real estate developments on or near proposed transit stations without the active participation of the public sector. The three major factors impeding private sector initiatives around transit are:

- Difficulty of Assembling Land in Urban Areas at Reasonable Cost;
- Limited Risk Capital to Buy Land in Anticipation of Transit Development;
- Uncertain Market Conditions in Urban Areas;

Examining these factors in closer detail, the problem of assembling land can be insurmountable without the assistance of the local transit agency. It is a time-consuming process which may be delayed and complicatd by reluctant sellers of key parcels of land. Furthermore, the announcement of an area's selection for a transit station has a tendency to greatly inflate land values irrespective of the local market conditions. These problems can be overcome through the use of public powers (i.e. eminent domain) to purchase land at market value. Without such public assistance, land assemblage by the private sector at reasonable prices is near impossible.

Another major deterrent to private sector real estate development around transit is often the lack of capital to buy and hold land in anticipation of transit development. For example, it is not uncommon for a transit station to be proposed for an area ten to fifteen years in advance of its actual construction. As proposed plans become reality, the private sector may indicate an interest in the land on or near the proposed transit station but again the problem of land assemblage resurfaces.

Uncertain market conditions in specific urban areas often discourage private sector developers from considering joint development projects irrespective of the availability of the land.

The public sector can ameliorate these types of private sector determinants by taking the lead in assembling property, holding the property until development is right, and providing financial incentives to reduce the "business risk" caused by uncertain market conditions. For example, the local transit agency may include a combination of the following in a joint development opportunity:

- **Reduction of project cost:**
  - -tax exemption or abatement
  - -write-down of land costs
  - -graduated leasing of land to developer to reduce initial project cost
  - -contribution of public facilities
- **Assumption of risk:**
  - -incur pre-development cost
  - -provision of loan guarantees
- **Creation of a market for the project:**
  - -leasing of space by public agencies
  - -financial support to prospective tenants
  - -provision of complementary facilities such as a convention center or other facilities for public use near or adjacent to the joint development site.

If these financial incentives are sufficient to overcome the present and future risks inherent in these markets, new opportunities for joint development may be created.

In any case, how local transit agencies address these and other similar private sector development issues is a local jurisdictional matter. Consideration must be given to the short and long-term benefits of public actions necessary to entice private sector participation in joint development projects.

B. Private Sector Participants, Roles and Goals

Among the principal private sector participants involved in joint development projects are developers, lenders (both construction and permanent) and equity investors. Each of these private sector participants plays an integral role in the design and implementation of a specific joint development project. The goals of the private sector in joint development are diverse and vary according to the individual participants involved.

Successful deal-making by DBEs requires knowledge of each participant, their role, and their objectives. The following briefly describes the roles of each of the principal private sector participants in the joint development process.

1. Developer

Without a developer there is no project. As defined in Chapter I, the developer is the lead person in the development entity (i.e. developer/group of investors) who conceptualizes the project, organizes, coordinates, and supervises the sources of capital, labor, and material throughout each phase of the project from beginning to end. The importance of the developer's role cannot be understated. Both the financial lenders and equity investors will make their decision to contribute capital to the project, based on their verification of the developer's credibility and track record in successfully completing similar projects. It is the developer who determines the economic potential of the joint development site. He or she must undertake a preliminary economic analysis to determine the appropriate commercial mix (i.e. hotel, office, retail, and residential) for maximizing the economic returns on the site. This economic analysis must reflect local economic market conditions and incorporate all planning, design and financial return requirements imposed by the local transit agency. The results of this preliminary economic analysis (refer to Chapter IV for details) will determine the economic feasibility of the project in meeting the local transit agency's requirements. Additionally, this analysis will define the type and level of equity capital/financing needed for the project. Consequently, it is the developer's role to define the scope and direction of the project and provide the leadership to bring the project to reality.

2. Equity Investors

Other major private sector participants in the joint development process are the equity investors. The equity investors can play an active or passive role depending on their financial objectives, level of investment, and timing of investment. It is common for equity investors to join their financial resources with the experience and track record of a developer and form a "development entity". As active participants, these initial equity investors are usually general partners with the developer. The initial investors put up the "risk capital" and the developer puts his/her skill, experience and sometimes capital into the venture. If the development entity is successful in obtaining the "development rights" to a joint development site, additional equity investors may be required. These latter equity investors usually are passive investors with no direct management responsibility or liability beyond their investment.

Whatever their role in the joint development process, the equity investors' motivation to invest comes from a desire to maximize possible returns from the real estate development.

3. Conventional Financial Lenders

Normally a project has two types of lenders: the construction lender and the permanent or long-term lender. The construction lender is usually a local bank which provides the money to build the project on the precondition that a permanent lender will take over the loan once the project is constructed.* Since the permanent lender has no takeout source, the market value of the completed project is critical for it serves as collateral for the loan. Both the construction lender and the permanent lender seek a secure loan based on the credibility of the development team's developer and market potential of the project respectively. A stable return with low risk best describes the goals of the lenders in the joint development process.

Having looked at the major private sector participants, let us now turn to the various objectives that private sector participants attempt to achieve through the joint development process.

C. Private Sector Joint Development Objectives

Joint development deal-making involves the sustained negotiation by multiple parties around specific objectives. The private sector participants seek to achieve objectives which can guarantee their various financial goals are met. Illustration II.A displays some of the objectives pursued by the private sector through joint development.

- **FINANCIAL FEASIBILITY**-Private sector developers, equity investors and permanent lenders seek a competitive financial return on their investment.

- **ABILITY TO ASSEMBLE LAND**-Successful private sector participation in joint development calls for public initiatives which provide ability to assemble land. Difficulties in meeting this objective pose serious problems to effective private sector participation in the joint development process.

- **FINANCIAL RISK REDUCTION**-In weak and uncertain markets public sector incentives which reduce risks are important objectives in joint development deal-making.

---

*In some cases, depending on the credit worthiness and credibility of the private developer, the local bank will take on the roles of both the construction lender and permanent lender. Normally the permanent loan is for no more than 5 to 7 years.

- **MAXIMUM MARKET POTENTIAL**-A key private sector objective is that relating to maximum market potential for a project. In particular, any restrictions imposed by the public sector which limit income realized by the project could be a significant consideration in the availability of permanent financing.

- **ACCESS TO LARGE PUBLIC INVESTMENTS**-Public transit investments normally support high density activities which allow a developer to maximize the yield on investment.

- **MINIMUM TIME DELAY**-From the private sector perspective, time delays represent additional expenses which must be covered. The objective here is to minimize hurdles which delay the process. Generally speaking, private sector participants are not adverse to conditions which improve the overall product or physical environment as long as the costs are reasonable and can be recovered.

IV. FACTORS IN ESTABLISHING A SUCCESSFUL PLANNING AND DEVELOPMENT FRAMEWORK

It should be evident by now that the success of a joint development venture can be judged by how well it responds to the objectives of the public and private sector participants. For a public/private co-venture to work, there must be public sector institutional support and coordination for joint development deal-making. Some of the factors found to be of paramount importance in creating a successful planning and development framework are:

- **INSTITUTIONAL POWERS AND ARRANGEMENTS**-In support of joint development deal-making, a public sector agency must possess the necessary legal authority to condemn, buy, sell and lease land, alter zoning and land use designations, and enter into agreements with private parties and other public sector agencies. The absence of such authority can bring unnecessary time delays which increase the risk to a developer.

- **STATION LOCATION AND ACCESS CONSIDERATIONS**-Station location and access considerations are factors which can predetermine the market value and design viability of a joint development project. For this reason joint development considerations should be included in the earliest stages of the planning process to ensure that the station location and access are compatible with joint development.

- **LAND ACQUISITION AND TRANSFER POLICIES**–Where state law allows, land acquisition policies can overcome one of the most difficult aspects of urban real estate development -- the assemblage of urban land for development. The public sector should consider land acquisition to avoid joint development land assembly problems.

- **COORDINATION OF ZONING AND LAND USE PLANNING**–For joint development to succeed, land around a transit station must be available for development in appropriate uses and densities. The land use and zoning conditions for transit station development must be coordinated with metropolitan jurisdictions along the transit route alignment in order to insure that growth is directed towards transit station areas.

- **CONTRACT BIDDING, AWARD AND PROCUREMENT POLICIES**–This area must be carefully examined for clarity of purpose and reduced to essentials. Properly designed policies and procedures in this area are of great assistance in avoiding difficulties and wasting precious time for both the public and private sectors.

These factors are essential to the implementation of a successful joint development process. How these factors are integrated into a workable joint development program can best be evaluated by examining the local transit agency contract bidding procedures and policies. DBEs are well advised to become familiar with the underlying assumptions and objectives used in the formulation of these contract bidding procedures and policies.

A. Issues in the Design of Contract Bidding Procedures and Policies

The contract bidding procedures and policies determine how effectively the joint development process satisfies public objectives while at the same time attracting experienced developers. The contract bidding procedures and policies establish the negotiation parameters between the transit agency and its selected developer. Consequently, great care and thought must be invested into designing bidding procedures and policies. Some of the questions which should be addressed in the design of a contract bidding process are:

- What are the local transit agency's objectives and which of these objectives are non-negotiable?

- How final must public commitments to project implementation be at the time of the offering?

- Will the offering have sufficient civic and political support within the community?

- Will public financial support be required for project feasibility?

- How can variations in selection rules stimulate or depress competitive interest?

- How can informal solicitation efforts prior to the offering be used in decision making?

- How much personal financial information should be required of submitting developers and how can it be treated with confidentiality?

- What is the level of detail required in the developer's development proposal and how binding are the developer's financial projections?

- What are the standards by which development proposals will be evaluated?

These basic questions are only an example of some of the issues which must be addressed in designing contract bidding procedures and policies*. Keep in mind that the answers to these questions must be translated into procedures and policies which will, in turn, establish the parameters of the deal-making environment. For this reason, DBEs should be concerned how DBE business opportunity plans are incorporated into the contract bidding procedures and policies.

DBE equity participation adds a new dimension to traditional participation goals and plans developed by local transit agencies in compliance with the DOT regulations.

B. DBE Equity Participation as Part of Contract Bidding Procedures and Policies

DBE equity participation can either be a positive or negative adjunct to the contract bidding process. Much depends on how successful the local transit agency is in developing a DBE equity participation plan which adds to the quality of the joint development project and enhances the economic viability of the venture. Remember, joint development projects are complicated financial and legal arrangements between the local transit agency and the private sector development entities. As a result, DBE equity ownership plans must be carefully thought out in order to ensure that DBE equity is real and does not hinder the economic viability of joint development projects or the financial return

*<u>Selecting a Developer</u>, National Council for Urban Economic Development, No. 25, March, 1983. Many of the basic questions and concepts expressed in this publication are reflected in this portion of the manual. This publication is an excellent introduction to selecting a developer.

to the transit agencies. This requires that local transit agencies establish specific DBE equity objectives with detailed plans for implementing and monitoring the effort. Unfortunately, only a few transit agencies have gone beyond the establishment of DBE equity objectives.

In order to establish an effective and positive DBE equity participation program, barriers and issues must be defined, objectives established, and an implementation plan, with specific strategies and tactics responsive to identified needs must be initiated. The following questions should be added in designing a DBE equity participation plan as part of the contract bidding procedures and policies:

- What are the primary objectives of DBE equity participation in the joint development program?
- Is the local transit agency prepared to forego some of its joint development financial return to help DBEs access equity ownership opportunities?
- What role should the transit agency play in identifying qualified DBE equity participants and/or DBE investors for upcoming joint development projects?
- What role should the transit agency play in educating the minority/women's business community about the opportunities in equity ownership in joint development projects?
- What weight, if any, will be given to various types of DBE equity ownership (i.e. general partner vs. limited partner) in the local transit agency's selection process of a development entity for a specific joint development site?
- How important is DBE equity in comparison to other DBE business opportunities created by the joint development project?
- What are the limits to the legal authority of a transit agency to enforce DBE equity ownership throughout the real estate development cycle (i.e. origination, operation and sale/ refinancing).
- Based on national experience, what are the key factors prerequisite to successful DBE equity participation as general partners or as limited partners?
- What are the traditional barriers to DBE equity participation and what strategies or tactics have been attempted to eliminate these barriers?

- What requirements must be established in the joint development agreement to ensure that a minimum level of DBE equity ownership is maintained throughout the real estate development cycle.

- What can be learned from selected joint development projects throughout the country which have DBE equity ownership participation?

- What standards and monitoring procedures should be established for ensuring DBE equity participation throughout the real estate development cycle?

How local transit agencies respond to these DBE equity participation issues is a local jurisdictional matter. Ultimately, resolution of these issues must include the active involvement of the DBE community, the cooperation of the private sector development community, and the commitment of the local transit agency staff to implement and monitor the effort. The measure of success for the DBE equity participation plan rests on the local transit agency's ability to maximize DBE equity ownership, without jeopardizing the economic objectives of the joint development program.

In conclusion, the local transit agency must develop a planning and development framework which reflects the critical factors necessary to implement a successful joint development program. The contract bidding procedures and policies integrate elements of these critical factors into an organized process by which the private sector can respond to a joint development opportunity and eventually negotiate the "rights" to develop the site. Basic questions regarding transit agency objectives, DBE participation and assumptions must be addressed in formulating of these bidding procedures and policies. Again, how these basic questions are answered and translated into procedures and policies is a local jurisdictional matter.

V. LOCAL TRANSIT AGENCY JOINT DEVELOPMENT SITE PREPARATION

Once a local transit agency has established a planning and development framework from which to sustain a joint development program, the transit agency is ready to address the implementation of specific joint development projects. As portrayed in Illustration II.A, the local transit agency must do a considerable amount of work to prepare a joint development site prior to private sector participation. Typically, these pre-development activities include:

- Transit Agency Land Options and Related Agreements

- Transit Site Facilities

- Site Selection Analysis

- Market Feasibility Analysis
- Coordination of Site Development with Other Public Agencies
- Financial Feasibility Studies
- Highest and Best Use Studies
- Some Local Approvals
- Allowances for Citizen Participation
- Project Prospectus

In essence, the local transit agency plays the role of the developer in the pre-development stage. The transit agency identifies the potential joint development sites along the transit routes, analyzes their marketability, determines their highest and best use, establishes economic feasibility, and acquires the sites. It must be emphasized that the preliminary financial analysis undertaken by the local transit agency does not represent the final financial plan for the project. The purpose of this financial analysis is to assist the local transit agency in evaluating developer proposals and eventually negotiating a detailed financial plan with the selected developer. The financial analysis of the site along with the other studies serves to establish the parameters of the prospectus.

A. The Offering Prospectus

A well prepared offering prospectus is essential for solicitation of the "development rights" to a specific joint development site. It should present a carefully worded description of the development rights and requirements, rules of submission, criteria for selection, and the basic financial parameters acceptable to the local transit agency. At minimum, the prospectus should include:

- Project Summary
- Project Setting
- Local Transit Agency Joint Development Program Objectives
- Objectives of Specific Project
- Development Requirements

- Offering Policies and Procedures
  - Selection Criteria
  - Timetable for Proposal Submission
  - Review and Approval Process
  - Information Developer Must Submit

Since the prospectus is the sole description of the project to be offered publicly, it should be comprehensive and self-explanatory. Should the local transit agency decide to make their preliminary design documents and market/financial analysis available to interested developers, the prospectus should reference their availability as well as any other documents pertinent to the project (refer to Appendices for an example of a joint development project prospectus).

It is absolutely imperative that DBEs interested in pursuing equity ownership opportunities carefully analyze the joint development project prospectus. All questions regarding the prospectus should be noted and answers should be requested from the local transit agency. An appropriate time to obtain clarification on the prospectus is at the "developer's conference" which is normally held by the transit agency immediately following the announcement of the solicitation for bids.

B. The Joint Development "Packaged" Opportunity

In the final outcome, the local transit agency is bringing a "packaged" real estate development opportunity to the negotiating table. This up-front public sector commitment of staff time and financial resources in preparing the joint development site represents a distinct advantage of transit-related real estate development for the private sector. Additionally, the pre-development analysis by the local transit agency will invariably produce economic parameters for the project which are consistent with the local market. This pre-development analysis reduces the uncertainty and financial risks to the private sector. The next section will present the process followed by the private sector in the formulating of a development program in response to the "packaged opportunity" presented by the local transit agency.

VI. PRIVATE SECTOR RESPONSE TO REQUEST FOR JOINT DEVELOPMENT PROPOSAL

The pre-development efforts by the public sector described above set the stage for the private sector to respond. In some cases requests for joint development proposals are solicited through major national publications. At times, a public sector agency may invite developers to briefings at which time joint development opportunities are presented.

Regardless of the procedures involved, a development proposal is the private sector's response to a "packaged" joint development opportunity presented by the public sector. Various elements must be incorporated into a development proposal. Among the most important are:

- Complete Development Plan Responsive to Transit Agency Criteria
- Economic Feasibility Study
- Pro Forma Financial Projections
- Sources of Financing
- Credible Equity Participation and Development Team
- Ownership/Legal Structure
- Compliance with Any Transit Agency Requirements

Two points should be emphasized. First, regardless of the method used to select a developer, a substantial amount of money will be needed to put together a development team and program which is acceptable to the local transit agency. With competitive bidding, the initial investment of time, personnel and money is at risk. There is no guarantee that a particular developer will be selected. Consequently, it behooves DBEs to carefully evaluate their chances to develop a "successful" development proposal for a specific joint development opportunity before securing the needed risk capital to prepare the development proposal. Second, the development proposal is only the first step in the process. If a proposal is selected, a DBE development entity's work has just begun. It must immediately begin to prepare the project for financing leading to construction and eventual operation as an income-producing real estate development venture. Chapter Four of this manual will address the preparation of the development proposal in greater detail.

VII. SELECTION OF DEVELOPER/JOINT VENTURE TEAM

The selection of a developer does not, in itself, mean that the chosen developer has been given the "development rights" to a specific joint development site. Rather, the selection process results in confirming the exclusive negotiating rights to the selected development entity. Usually, this award is formalized by a memorandum of understanding between the parties (normally for renewal periods of six (6) months). Final negotiation of the "development rights" occurs some months later after the developer has completed the final design and refined his/her financial

plans. A local transit agency may employ various approaches for selecting a development entity. Among the most common approaches are:

- **Development Entity Pre-designation**

  This approach may be taken when the development entity offers a unique "packaging" opportunity to the local transit agency for a specific site. For example, a land owner/developer may own a parcel of land adjacent to the transit station property. Or, a development entity may offer the transit agency community improvements in exchange for the "development rights" to a specific site.

- **Direct Negotiated Selection**

  This approach is the basis for many unsolicited proposals. It occurs when a development entity, at its own initiative, makes a proposal to develop a transit agency controlled parcel of land in the absence of competing offers. If the transit agency likes the development proposal, the transit agency has the option to enter into serious negotiations with the development entity.

- **Competitive Selection**

  Competitive selection is a common approach usually employed when there is a strong development interest in a project or when a public agency wishes to open up the process to as many development entities as possible. Competitive selection of a development entity may involve non-price competition where such factors as design criteria and/or development program play a key role in selection of development entity. In other instances, a public agency may establish a fixed price and development entities compete on the basis of non-price factors.

Regardless of the method employed for selecting a developer -- i.e. competitive bidding or "sole source"-the transit agency should:

- Establish objective criteria for reviewing and evaluating development proposals*;

- Check the developer's references and development team's credentials;

---

*Each joint development site is unique. The local transit agency must ensure that selection criteria are developed which reflect the distinctive characteristics of the site and its community environs.

- Form a special selection panel or committee to review, evaluate and select a development team; and
- The selection decision should include a first and second choice in the event the negotiations with the first choice developer cannot produce an acceptable final agreement.

VIII. PARAMETERS OF DEAL-MAKING

Deal-making is a highly creative aspect of joint development and one which sets the groundwork for building a project through binding commitments negotiated across a bargaining table. Since many joint development prospectus are issued with non-negotiable items, such as design standards, minimum rents, etc., by the time public and private sector participants proceed with negotiations many of the parameters of the deal are already established. Nevertheless, it is often common for public and private participants to negotiate such items as:

- Level of expected income based on market analyses;
- Land acquisition and disposition agreement terms;
- Access agreements;
- Provisions for public facilities and/or public space;
- Management of coordinated design and construction;
- Adverse site conditions;
- Operating agreements for efficient long-term management of non-transit related facilities;
- Construction specifications;
- Joint obligations;
- Scheduling and management of combined construction; and
- Pre-leasing agreements.

In preparing for deal-making, a DBE development entity must recognize that successful negotiation with a public agency depends on:

- The financial and non-financial objectives established for the project; and
- The relative bargaining ability and strength of each participant.

The former is established in the course of preparing a joint development proposal by analyzing three major areas of project feasibility. First, a market profile that includes an estimate of a project's development potential. Second, a short-term cash flow projection for that period when a project is most susceptible to default (e.g. the first 5 years). Third, a long-term capital investment analysis that establishes a project's rate of return. These projections assist a development entity in establishing a strategy in relationship to those items which are negotiable.

The nature of negotiated commitments also depends to a large extent on the relative bargaining ability of each participant and the nature and complexity of the project. For example, a joint development project in a weak market may generate more concessions from a public agency than one located in a strong market primarily because risk assumption by the public sector may be essential to achieve its objectives. Similarly, a large and complex joint development project may involve provisions for pedestrian traffic flow between transit and commercial components of the project. If substantial structural alterations are required, the allocation of costs for such alterations can be a subject of negotiation.

The results of the negotiations are translated into a firm or legally binding commitment often expressed as a "development contract" detailing the basic items agreed upon by the participants. Once the contract is duly authorized, the development team is ready to undertake the various phases of the real estate development process (i.e. Final Design, Financing, Construction/Marketing and Operations). Chapter Four will address the development process in greater detail.

In conclusion, the success of the deal-making depends on how successfully the joint development process achieves the following:

- Preparing the site for joint development consideration;
- Attracting the right development entities to compete for the opportunity;
- Selecting the right development entity; and
- Satisfying both the public and private sector objectives.

IX. DBE STRATEGIES FOR PARTICIPATING IN THE JOINT DEVELOPMENT PROCESS

The public sector planning/policy process is key in setting up the conditions for deal-making. Public transit policies establish the deal-making environment in which investors,

developers, lenders and public agencies will negotiate their agreements. Therefore, it is absolutely essential that the disadvantaged business community understand how the planning/policies process works. Once the planning and development policy framework of the local transit agency is understood, the next step is to identify critical DBE entry points.

Let us now examine some of the critical DBE entry points in joint development process.

A. Local Transit Agency DBE Goals

Referring to Illustration II.A, Public Sector Goals, please note the DBE participation goals of the local transit agency. The use of Federal transit subsidies in the design, planning, construction and operation of the transit system imposes certain DBE goal requirements on the local transit agency. Notwithstanding these DBE goals for Federal funds, DBE equity participation in joint development is not Federally mandated. It is a local issue. Consequently, the local transit agency planning process will respond to DBE equity participation objectives to the extent that the DBE community is able to obtain a commitment from the local transit agency Board of Directors.

DBEs must work with the local transit agency Board of Directors and understand the following:

- the limits of its authority;
- the method and selection of decision-makers (i.e. board of directors, chief operating officers, etc.);
- its functional areas of responsibility;
- its planning process and key decision points;
- its design process and key decision points;
- its development process and key decision points, etc.; and
- its policy making process and key decision-making points.

Prominent DBE business leaders and non-minority leaders who are sensitive to DBE participation and the benefits of joint development, should take an active involvement on the Transit Board of Directors, especially on the joint development policy committee. DBEs should also seek the assistance of the transit agency Office of Civil Rights or DBE Office and solicit their support to promote procedures for meaningful DBE equity participation in joint development projects.

B. Integrate DBE Equity Participation into the Private Sector Joint Development Objectives

Traditionally, the private sector (i.e investors, developers and lenders) have viewed DBE equity participation in multi-million dollar joint development ventures as a burden imposed by a zealous transit agency. Unqualified DBEs have been lured to a joint venture team to satisfy a DBE equity participation requirement because the joint development competitive bidding procedure required it. This type of token DBE equity participation is not necessary. There are qualified DBEs and minority investors (professionals, doctors, attorneys, etc.) in every major city in the country.

This is an area in which the local transit agency, in cooperation with the DBE business community, can play a most important role. Having established DBE objectives in the joint development program, the local transit agency should initiate an outreach program to identify and inform DBEs of the upcoming joint development opportunities. Equally important in this local transit outreach initiative is an education program which realistically sets out the benefits, risks and advantages of joint development with an emphasis on the prerequisites to playing the joint development equity game. Such a local transit agency strategy can result in private sector willingness to include DBEs as equity partners in their projects.

C. Competitive Bidding Procedures Which Require DBE Equity Participation

The willingness of the private sector to accept DBEs as equal partners in a joint venture team must be initiated by the local transit agency through the competitive bidding procedures. Remember, transit policies set the parameters of the deal-making environment with the private sector. DBEs must take an aggressive approach to insure that the competitive bidding procedures include DBE equity participation. In the absence of a local transit agency's commitment to DBE equity participation in the competitive bidding procedures, DBEs will continue to be reluctant to commit limited financial resources to compete against major developers and investors in acquiring the "joint development rights" to a specific site.

D. Transit Agency Land Acquisition as a Means to DBE Equity Participation

Without transit agency control or access to land on or adjacent to a transit station, there will be no DBE equity ownership joint development opportunities. The availability of urban land rights is to joint development as water is to fish. It is only when the public sector has control of the land or access to the "development rights" of a site that the transit

agency can maximize its share of the economic returns of the transit-related real estate development project*. Equally important, the control of the joint development site places the local transit agency in the position to require DBE equity participation in the project. Without initial control of the land by the transit agency, DBE equity participation will be difficult at best and likely non-existent.

Nevertheless, this is an important lesson to be learned. In those situations where the local transit agency has control of the land on or near transit stations, DBEs should work diligently to ensure that all real estate development on these sites includes DBE equity participation. Furthermore, DBEs should identify all land owned and controlled by the local transit agency and follow the proposed uses for this property.

E. DBE Equity Participation in Weak and Uncertain Joint Development Market Areas

Regardless of public financial incentives, weak and uncertain markets present unique problems and higher risks. In weak markets a local transit authority can, through joint development, assist in revitalizing the local economy. It can write-down the cost of land so as to promote development. DBEs involved in such projects can make a contribution to the development of their community. However, special care must be taken lest the local transit agency relegate DBE investors to weak and uncertain markets. Remember, banks do not fund what developers build; developers build what banks will fund. If the real estate development cannot generate income, why should banks risk their financial resources? The market feasibility of a project is critical. Ignoring market realities can spell disaster for a DBE entrepreneur as well as for a local transit agency.

F. New Opportunities for Passive Equity Participation in Joint Development

Although this manual places a strong emphasis on DBE equity participation in which minorities and women are deal makers, the economic benefits of passive equity participation in joint development projects must not be overlooked. Minorities should seriously consider the economic benefits of participating in

*The proposed Southern California Rapid Transit District (SCRTD) Wilshire Corridor Mass Transit System in Los Angeles is an exception to this rule. Because of its underground design along a well established commercial strip, SCRTD is attempting to negotiate value capital agreements with existing property owners. This situation leaves little opportunity for imposing DBE equity participation in these agreements. As of January, 1986, UMTA financial assistance for this project is uncertain.

joint development projects as limited equity investors. As limited equity investors, minorities could invest their financial resources in joint development projects, without the burden of having to be involved in the day-to-day decisions of managing the joint development project, yet receive the benefits of ownership.

There are many ways of structuring limited equity investments in real estate development investments. One variety of the limited partnership structure as a means of attracting equity investors is syndication.

> "The way that syndication usually works is this: the developer -- who up to this point may be the sole owner of the project -- will form a limited partnership. Every limited partnership must have at least one general partner who has unlimited liability for the debts of the partnership . . . and one limited partner, whose liability is the extent of his or her initial investment. The original developer usually becomes the general partner in the newly created limited partnership. The general partner then sells (or someone else sells on the developer's behalf) partnership interests to other individuals, who become limited partners in the partnership. Limited partners will pay cash to own partnership shares, entitling them to share in the financial benefits produced by the project. The shares are expressed as percentages of ownership in the project. The cash that they pay to become limited partners is referred to as capital contribution."*

While a detailed treatment of syndications is beyond the scope of this manual, one important factor about syndications must be pointed out. Real estate syndications are highly regulated by Federal and State laws (see Chapter III). Additionally, equity investors must meet certain personal financial standards to "qualify" as potential investors.

Most recently finite life Real Estate Investment Trusts (REIT)** have demonstrated ways to overcome the "suitability standard" imposed by Federal and State laws while providing the security of a syndication yet allowing investors to invest as little as $1000. REITs and other new financial investment methods could offer an innovative way for local transit agency's to extend the economic benefits of a joint development project to a wider range of potential minority investors.

* Real Estate Development Syndication, Howell, Joseph T., 1983.
** Fact Magazine, March, 1984.

In concluding this discussion on DBE equity ownership strategies, DBEs must recognize that the success of any strategy or combination of strategies to increase and promote DBE equity ownership will depend on how well these strategies work:

- Maximize DBE equity ownership;
- Enhance the quality (i.e. management, design, community support, etc.) of the project;
- Improve the financial feasibility of the project; and
- Meet the public agency's objectives.

Achievement of these goals will require the full cooperation of the local transit agency, DBE community and the non-DBE development community.

CHAPTER THREE

JOINT DEVELOPMENT EQUITY OWNERSHIP AS AN INVESTMENT DECISION

OVERVIEW

Despite the financial benefits offered by transit-related real estate equity ownership investments, these types of investments are not for everyone. In order to assist DBEs decide whether they should pursue equity ownership opportunities, this chapter provides a general discussion about real estate investments. Moreover, the special requirements of transit-related real estate development projects are discussed. The chapter concludes with a self assessment to assist DBEs in evaluating their financial objectives; thereby, allowing them to decide which form of equity ownership best suits their financial objectives.

I. EQUITY OWNERSHIP IN JOINT DEVELOPMENT IS AN INVESTMENT DECISION

With few exceptions, income-producing real estate investments are one of the best forms of asset-building, tax-saving and long-term wealth creation. Commercial real estate has long been recognized by individuals, major corporations and pension investors as an attractive means of diversifying an investment portfolio. Based on its historical performance as an investment, income-producing real estate investments have proven to be a long-term hedge against inflation and downturns in the economy. Transit-related real estate investments are one particular type of income-producing real estate investment which could be suitable for a broad range of DBE investors.

Before making an investment in a joint development project, DBEs must determine their capacity to do so. Several factors must be considered. First, DBEs must understand the characteristics, benefits and risks associated with real estate investments in general and the specific prerequisites of transit-related real estate development projects. This knowledge is important for it allows DBEs to identify and structure real estate investments which maximize total return relative to risk. Second, DBEs must be able to evaluate the potential financial benefits and risks of equity ownership in joint development in light of their personal financial objectives.

II. CHARACTERISTICS OF REAL ESTATE INVESTMENTS

The benefits and risks in real estate investment derive, in part, from its special characteristics when compared with other types of investments such as intangible property (stocks, bonds, etc.) and tangible purchases (gold, diamonds, antiques, etc.). To some extent, nearly all the special characteristics of real estate arise from its quality as a fixed location investment. To this end, real estate investment is not a "get rich quick scheme"; rather, real estate ownership is a long-term process of wealth creation. If you understand the special characteristics of real estate and the hidden cost, you stand less chance of meeting unexpected expenses. Real estate exhibits the following characteristics:

- **Immobility of Asset**

Immobility of asset means that the physical investment can not be moved from one location to another. This obvious condition has some important consequences. Whereas other investments such as bonds, stocks, gold, antiques etc. can be sold elsewhere if there is no local market for resale, real estate investments are a captive of the local economy and environment. Given this inescapable tie to the "local economy", selection of the right location is especially

critical for income producing commercial property. Despite their association with a regional transit system, joint development projects are not an exception to this rule.

- **Value of Investment is Affected by Surrounding Neighborhood**

A parcel of real estate is affected by surrounding properties and neighborhood improvements. This interplay among local surrounding improvements may increase or diminish the value and appreciation of the property. Of all the types of real estate (i.e. residential, commercial and industrial), commercial real estate is most sensitive to location. It is therefore important to analyze the present and future zoning, as well as land use and economic trends in an area. These considerations should be set forth in a detailed market study and site analysis. The investor should be satisfied as to the present and future economic potential of the site before a commitment to invest is made.

- **Useful Life**

Useful life refers to the number of years over which asset value of property will be allocated. There are two factors which determine the useful life of a property. There is (1) economic depreciation, and (2) physical depreciation. Economic depreciation is a loss in demand for a particular property due to economic conditions surrounding the property. Physical depreciation is a loss in value due to actions of the elements: wear and tear or structural aging.

- **Lack of Liquidity**

Real estate lacks ready "liquidity" which is the ability to turn an asset into cash quickly. This is complicated by the fact that a quick sell (seldom less than a month) may force the investor to take a discount for his investment.

- **High Unit Cost**

Nearly all pieces of real estate, even small properties, are costly. Unless you can pool your capital with other people, such as in a real estate limited partnership, there are relatively few opportunities for small purchases. The availability of mortgage financing and the level of interest rates play a most important role in determining the feasibility of the real estate development and its resale potential.

• **Management Requirements**

Real estate must be properly managed in order for it to produce economic returns to its owners and investors. Tenants, repairs, maintenance and operations all demand attention. Care must be taken to select your property management team and arrange for all the guidelines, policies and procedures necessary for operating an effective and efficient income-producing property. Moreover, specialized services (i.e. tax accountants and lawyers) are often necessary to maximize the overall return from the investment, because tax laws seriously affect the investment returns accruing from ownership.

These basic characteristics of real estate must be kept squarely in mind in the process of evaluating transit-related real estate equity opportunities. And of these basic characteristics, location and the local economy market play an essential role in determining the type and success of joint development projects. Furthermore, investing in a joint development project is like other real estate investments, in that these are long-term opportunities requiring substantial investment of capital and demand constant supervision of the investment to ensure a maximum return.

Owning investment real estate is not unlike owning a small business. Some would claim that it is easier than owning a small business, while others claim real estate development is a highly specialized business. The fact of the matter is that real estate ownership requires no more technical knowledge than do modern security investments such as stocks and bonds. Nevertheless, one thing must be kept clearly in mind. Practically all the wealthy real estate entrepreneurs became so through organizing investors into groups rather than through developing or acquiring income producing properties by themselves.

III. BENEFITS OF INVESTING IN REAL ESTATE

When all the fanfare is over, there are only three basic investor goals: (1) Security, (2) Income, and (3) Value Appreciation. The financial benefits and financial risks of real estate investment vary according to the kind of property, financing, timing, marketability and location. Additionally, the special characteristics of real estate itself greatly influence the economic return obtained for the investment.

In Chapter One, the financial benefits of income-producing real estate investments were introduced. These financial benefits are restated in this section along with other benefits generally attributed to real estate investments. <u>Not every property offers these benefits to the same degree</u>. Nor can every

investor use the same investment to realize the same level of return because everyone's financial status differs in terms of tax status, credit standing, source of financing and other income. Nine benefits of investing in real estate are:

- **Leverage**

The use of debt financing (mortgage) has two major advantages. First, debt financing means that real estate can be purchased with a relatively small down payment (10% to 20%) to gain control of large investments while taking a long length of time for repayment. This enables you to leverage your investment to control higher priced properties and earn large returns on the cash invested. Second, debt financing on real estate projects are usually non-recourse loans (i.e. A loan in which the borrower has no personal liability, and the lender's only recourse in the event of a default is the assumption of ownership of the collateral security (real estate improvement and land) on the loan).

- **Cash Flow**

Real estate offers the opportunity for your cash investment to yield an income stream during ownership (gross income minus debt service and operating expenses). Before tax yields of 10% - 15% are common in real estate.

- **Income Tax Benefits**

Real estate allows you to shelter your income. This is possible because both interest and depreciation are deductible from the net income of the property and other ordinary income. Income received from the sale of the property after one year is called capital gains and is taxed at a much lower rate than ordinary income.

- **Tax-Free Refinancing**

Proceeds from refinancing property are not taxable income to the owner. Therefore, refinancing is a way to recover your cash investment and, in some cases, your profit is tax free.

- **Equity Build-Up**

As the mortgage on an income producing property is paid-off, the value of your equity investment will steadily rise. Most income-producing real estate mortgages are not fully amortized since there are obvious advantages to refinancing the property. For example, if a property is refinanced, cash received on borrowing is not taxable, even though an investor may have borrowed in excess of the property's

basis. The owner's price for this privilege is the payment of interest, an expense that is normally deductible.

- **Appreciation**

The value of commercial real estate increases not only because of inflation but also because over time rents will increase, thereby increasing the economic value on capitalized cash flow of the project.

- **Stability of Growth**

Real estate values and prices, although influenced by current interest rates, have historically exhibited few of the fluctuations of other investments.

- **Division of Ownership**

Real estate investments have the unique characteristic which allows the ownership to be divided among an unlimited number of investors which reduces your initial investment while at the same time reducing the associated risks of ownership. It is an attribute of real estate investments which allows you to invest in multi-million dollar joint development projects as an equity partner.

- **Management Control**

Real estate investments require a development team of professionals to take the investment from concept to operation. Throughout this development process you, as the owner(s), have control over how, when and by whom the project will be completed. Control over the investment is the key to its success.

IV. RISKS OF INVESTING IN REAL ESTATE

None of the benefits of investing in real estate is available to the owner of real property without some amount of risk. Virtually all transit-related real estate development projects require new construction or substantial rehabilitation. Consequently, joint development projects have no history of operational cost and cash flow. By investing in the equity ownership of a joint development project, certain cash outflows are sacrificed for uncertain cash flow. Despite the fact there are guidelines (refer to Appendix for sources) which have been developed for various types of commercial projects* (i.e. hotels, retail, residential, etc.), each real estate project is unique.

*These guidelines for commercial properties (i.e. retail, office, hotel, etc.) include such things as cost of (CONTINUE NEXT PAGE)

Forecasting the future cash flow from a real estate investment is risky. Risk is associated with the inability to forecast a number of variables accurately. Since it is very difficult to forecast future events with accuracy, the difference between expected returns and actual returns is the extent of the financial risk.

How appropriate an investment decision is can only be evaluated by how well the investor, in this case the DBE investor, knows his/her financial objectives and financial strengths and weaknesses.

You may have heard the phrase "The higher the risk - the higher the return." Perhaps this is true but many people take unnecessary risk because they do not understand the causes of risks and how to minimize risks. If you must rely on others for all your real estate investment advice or if you have to make intuitive decisions through lack of training or knowledge of the nature of real estate investing, you increase the chance your investment will not meet your financial objectives (see Chapter Four).

The following provides a brief description of the six most common risks associated with real estate development investments:

- **Business Risk**

  The "business risk" is the risk that the transit-related real estate development project in which you are investing will go bankrupt due to problems in construction, poor market conditions or insufficient capital. Specifically, the project could be delayed by an act of God from storms and floods, storage of materials, labor strikes, and construction problems (i.e. hitting rock, etc.). Delays in project construction result in additional and unexpected interest cost during a period when there is no income stream. As a result, the greatest personal risk occurs

---

* CONTINUE FROM PREVIOUS PAGE -- construction, optimal size of retail space by type of user, space efficiency of office configurations, size of typical hotel rooms, expected financial cost centers within mix of commercial space, local historical leasing rates and hotel room rates, management requirements, etc. Lenders also use these guidelines in the explanation of real estate projects. Therefore, it behooves you to compare your project design and financial projections with these guidelines. If your project differs from these guidelines, you must know how and why. Herein lies the unique aspects of your project which must be justified. The Urban Land Institute in Washington, D.C. has an excellent series of publications on real estate development guidelines.

during construction prior to obtaining permanent financing (i.e. non-recourse loan). Additionally, the revenue projections may be incorrect due to a lack of understanding of market conditions, economic recession, or changes in the market which could have negative impacts on theproject's revenue. These types of business risk are fully assumed by the real estate investors. As a general partner or majority owner, you take on the major liability in case of business failure. The risk can be reduced by sharing it with other partners or participating in the investment as a limited partner in which case your liability is limited to your investment contribution.

- **Interest Rate Risk**

The interest rate risk has three major dimensions which influence the potential return on investment:

- Interest rates may go up during the time you are negotiating the purchase or seeking financing. This is particularly a concern in large real estate developments which may take several months from the time the investment opportunity was identified to the time construction and permanent financing is secured.

- Non fixed-rate financing has the potential to greatly disrupt your construction cost projections and affect your operational expenses.

- Increased interest rates can make it more difficult to sell your property when the time comes. In other words, your property may be producing a relatively good income, but the cost of financing due to high interest rates may make your property uneconomical to acquire.

- **Market Risk**

The market may change during construction of your project therefore negatively impacting on your projected income. This may be the result of either unrealistic market demand projections or the result of regional, national, or international economic conditions which are beyond your immediate control.

- **Purchasing Power Risk**

Although real estate values respond well to inflation, there is still the risk that when you get your money back, it will buy less than when you invested it. If the level of business risk is acceptable, then the investment stands a very good chance of preserving purchasing power during periods of inflation.

• **Political Risk**

Adverse government action can and does affect the value of the investment. Real estate investors face a higher degree of political risk because their investment is tied to the land which is subject to local government zoning laws and variances, road locations, etc. In regard to joint development projects, local political risk concerns are usually resolved prior to the formal announcement for request for proposal. Additionally, at the national level, government regulations may modify tax shelter benefits and affect the financial institutions lending policies.

• **Liquidity Risk**

This is the risk that you may lose some or a major portion of your investment in the process of converting your investment to liquid assets, (e.g. cash) as a result of a forced or untimely sale. Additionally, in the event you are one of many investors in the development project, it may be impossible for you to sell your minority interest at your convenience. Therefore, you should have the financial ability to carry your investment for a substantial number of years.

V. SPECIAL CONSIDERATIONS IN INVESTING IN JOINT DEVELOPMENT PROJECTS

Real estate investments can offer extraordinary returns on your investment when compared to other traditional forms of investment. But deciding to go into real estate is only the first step. You must carefully examine each and every real estate investment opportunity to ensure it meets your personal financial objectives, within the constraint of available resources.

In the beginning of this chapter, joint development was defined as a real estate product which results from an investment decision. This investment decision must take into consideration the inherent characteristics of transit-related real estate development investments. It is these characteristics of joint development which impose special prerequisites on equity investors be they minority or otherwise. Among these are the following:

• **Magnitude of the Investment**

Although joint development projects vary in size and scope, for the most part they are multi-million dollar commercial real estate projects (hotels, office buildings, shopping centers, etc.). The magnitude of such projects may limit the level of participation of potential DBE equity investors.

• **Competitive Bidding Procedures**

With rare exception, obtaining the "development rights" to a transit-related real estate development site owned or substantially controlled by the local transit agency requires the preparation of a competitive bid proposal. Given the competition for a proposed joint development site, DBEs must evaluate their ability to prepare a winning proposal (refer to Chapter Four).

• **Multitude of Actors**

Bringing a joint development project to fruition requires the coordinated efforts of many professional services and public agencies. Among these are: architects, attorneys, developers, contractors, lenders, public officials and political leaders. To succeed, it must be a team effort made up of experienced individuals who have undertaken similar commercial projects. DBEs must carefully choose their development team and ensure th ongoing coordination and communication among th appropriate development team members and public secto representatives.

• **Unique Product**

In joint development projects, the equity investors are buying a pro forma (hypothetical) bottom line. As previously noted, guidelines do exist for designing the project's commercial mix and structuring the financial projections based on other similar projects. Nevertheless, the proposed project does not exist and no historical earning records can be examined. Since there is no history, the investors' understanding of the marketplace and the needs of the uses of space is even more important.

The following Illustration III.A attempts to compare and contrast the distinctive characteristics of joint development projects with typical real estate development projects.

Illustration III.A

CHARACTERISTICS OF TYPICAL AND TRANSPORTATION-RELATED REAL ESTATE DEVELOPMENTS

Characteristics (Dimensions)	Typical Real Estate Developments	Transportation-Related Real Estate Developments
Cost (How Much)	May Range from Low Cost (Thousands) to High Cost (Millions)	Normally Multi-Million Dollar Projects
Participants (Who)	Architects, Attorneys, Developers, Contractors, Lenders, and Related	Includes Those Involved in Typical Real Estate Developments plus the Local Transit Agency and/or Development Authority
Type of Development (What)	Commercial, Industrial Hous , Medical, Etc.	Normally Income-Producing Commercial Properties
Length of Development Period (When)	Ranges from Less Than One Year to Longer Depending on Project	Normally Long-Term (5-10 yrs.) from Start to Finish
Location (Where)	Virtually Unrestricted, Wherever There Is Opportunity	At Site of Transportation Improvement
Development Process (How)	Real Estate Development Process	Co-Development Process*
Purpose (Why)	To Respond to Need for Specific Type of Real Estate Development Proposed	Same as for Typical Real Estate Development Plus To Further Public Transportation Objective

*The co-development process is simply defined as a real estate development in which both the public and private sector participants have an active and responsible role in implementing the various phases of the real estate development process (i.e. concept, feasibility, final design, financing, construction and operation).

VI. DETERMINING YOUR FINANCIAL OBJECTIVES

Equity ownership in transit-related real estate development can offer extraordinary financial benefits. This is true if and only if you are sufficiently secure in your financial position to accept the financial risks associated with this type of long-term investment.

For this reason, every DBE contemplating an equity investment in a joint development project should have a financial plan based on current financial position and income and on reasonable expectations of future financial position. Chances are, if you are reading this manual, you already have a personal financial plan and an investment portfolio. The important thing now is to evaluate where you are in achieving your personal financial objectives in order to determine what type of equity ownership in a joint development project will best suit your investment needs.

We will briefly review three life cycle investment concepts useful in making real estate investment decisions. These concepts are:

- The investor life cycle
- The real estate investment life cycle
- The ownership life cycle

These concepts attempt to integrate your personal financial objectives over time with the corresponding benefits and risks inherent in real estate investments in general and transit-related real estate investments in particular. Illustration III.B describes the interrelationship among these concepts.

Illustration III.B

INTERRELATIONSHIP OF LIFE CYCLE CONCEPTS

INVESTOR LIFE CYCLE	REAL ESTATE INVESTMENT LIFE CYCLE	OWNERSHIP LIFE CYCLE
Define amounts and types of returns and risks that are acceptable	Choose stage of life cycle that represent acceptable returns and risks	Analyze returns and risks using full life cycle cash flow forecasts

Let us now examine each of these life cycle concepts in detail.

A. The Investor Life Cycle

It is commonly believed that all investors experience a "life cycle" of their own, one that is related primarily to age, in which they seek different types of returns and risks at different stages. These stages are: the **Feeding Stage**, the **Growth Stage** and the **Benefit Stage**. The Feeding Stage is the period during which savings from one or several income sources are used to create portfolio investment assets. The emphasis at this stage is on a personal budget. Such a budget is essential in planning for the systematic saving that will provide the capital to be used in acquiring appropriate assets for your portfolio. The length of time you remain in this stage is directly related both to your willingness to sacrifice immediate wants in order to maximize saving and to the success of your investments in producing expected returns.

The Growth Stage is achieved when the portfolio is capable of producing income (ordinary income or capital gains) in sufficient quantity so that your investment and reinvestment goals become self-sustaining. At this point you may produce a synergistic effect by continuing to feed savings into your investment portfolio.

The Benefit Stage is achieved when the portfolio is generating current income sufficient to satisfy your personal financial objectives, plus provide for management costs, thereby allowing you, the DBE investor, to conserve the capital assets of the portfolio. In this stage, your investments are generating enough income to make you "financially independent".

The following are examples of individuals who have gone beyond the Feeding Stage.

Mr. James B. Howard

Mr. James B. Howard is currently a successful black attorney specializing in international law. In 1960 he graduated from law school. That same year he established a financial plan to acquire a net worth of $500,000 by 1980. As a law clerk he saved $100.00/month for two years. After passing the bar examination in 1963, he increased his saving to $300.00/month. By 1965 Mr. Howard had $10,000 in savings. He used $5,000 for a down payment on a $22,500 home. He placed the other $5,000 in low-risk blue chip stocks. As his salary increased, Mr. Howard increased his savings.

By 1972, Mr. Howard was ready to leave the Feeding Stage and enter the Growth Stage. He had $28,000 in savings. He borrowed $32,000 on the

appreciated value of his home. He invested $60,000 in acquiring a twenty-unit apartment building. The positive cash flow and tax benefits from this income-producing property allowed him to save an additional $50,000 by 1975. He sold the apartment building and purchased an 80-unit apartment building with part of his profit and savings. He diversified his financial portfolio with higher risk stocks and bonds and with the other part of his profit and savings. By 1977 Mr. Howard had a net worth of $500,000. He continued to buy and sell residential/ commercial real estate and continued to save from his salary. By 1980 Mr. Howard had a net worth in excess of $1,000,000 at the ripe old age of 45.

By the standards set for himself, Mr. Howard had achieved the Benefit Stage of his investor life cycle in 1980.

Mr. Gregory D. Garcia

Mr. Gregory D. Garcia is a successful entrepreneur in a variety of businesses. His parents were migrant farm workers from Mexico. He finished the eighth grade in 1952. That same year he started working as a full-time cook in a Mexican restaurant. His first major personal goal was to graduate from high school, which he did in 1960. His second goal was to own and operate his own restaurant. With $1,500 in savings, he leased a two-story building to start his own Mexican restaurant in 1961. With his family living on the second floor above the restaurant, he was able to save extra money. With his wife as an employee, he was able to further reduce expenses during the formative Feeding Stage.

By 1967 Mr. Garcia was ready to expand. He acquired a fifteen year lease on a larger building in an excellent location to open his second restaurant. In the Spring of 1970, Mr. Garcia obtained financing to construct his own building for his third restaurant next to a large shopping center. With three successful restaurants in operation, Mr. Garcia was now beginning to save a substantial portion of his income. He had now entered the Growth Stage.

Between 1975 to 1980, Mr. Garcia purchased and sold various income producing properties. By 1980

Mr. Garcia had a net worth in excess of $2.5 million with ownership interest in his restaurants, a local chain of hardware stores, residential property and two shopping centers.

Despite the accumulative wealth of Mr. Garcia, his personal financial objectives remain unfulfilled. He continues to operate as if he just started the Growth Stage.

The important thing to note from these examples is not the amount of net worth, but rather the fact these individuals set out to deliberately pass through each stage of the investor cycle. According to the U.S. Department of Labor, less than 3% of the population in the United States retire financially independent of "social security". The purpose, then, of these examples is to highlight the way in which an individual can pass through the investor cycle if he/she establishes a financial plan with specific financial objectives.

The motivating force underlying the "investor life cycle" is your personal beliefs and values as they relate to savings and investing. In other words, your personality and attitude towards investing are important factors in determining the "suitability" of any real estate investment. Investing in real estate, therefore, requires that you determine how you feel about such things as liquid investments, complicated documents and financing arrangements, and the possibility of wrestling with the tax code.

Although there are no fixed decision rules, the following personal financial assessment, Illustration III.C, can assist you in determining your "suitability" in participating in transit-related real estate development. As you go through this personal financial assessment keep in mind that there are different ways of investing in real estate development projects. The method of investing in a project must be directly related to your financial objectives, level of acceptable risks and desired benefit.

The questions posed by Illustration III.C must be addressed and truthfully answered. This exercise will assist in evaluating your strengths and weaknesses as a potential DBE investor*. Knowing your strengths and weaknesses, you are now in a position to formulate a strategy to leverage your strengths and overcome your weaknesses as an equity owner.

*The questions posed by Illustration III.C also apply to non-profit community economic development corporations. These organizations must make an internal evaluation of their organizational priorities, organizational capabilities and financial resources to participate in joint development equity opportunities.

Illustration III.C

PERSONAL FINANCIAL ASSESSMENT

STEP 1. EVALUATE YOUR FINANCIAL POSITION

a. Is your household income high enough to require you to set aside additional income in order to pay large tax bills at tax time?

b. Have you satisfied your own housing preference by owning or renting?

c. Are you adequately insured against appropriate risks? For an individual five types of insurance are usually necessary: life, health, hazard, business and personal liability and disability.

d. Have you set aside savings, cash value of insurance, and other liquid assets to provide for emergencies?

e. Do you have an estate plan for your heirs?

f. Is your income level high enough to benefit from tax shelters?

g. Are your liquidity reserves adequate for the risks associated with your current investments and those you contemplate in the next few years?

These questions should be satisfactorily answered in the positive before you seriously consider investing in transit-related real estate investment projects.

STEP 2. ESTIMATE YOUR NEED OBJECTIVES

a. Are your investment needs long-term or short-term?

b. Do you seek income or capital growth?

c. Is your level of risk aversion high or low?

d. What is the minimally acceptable average annual rate of return (after taxes) for a real estate investment?

If your financial need objectives are long-term, capital growth, and risk aversion is relatively low (e.g. you can afford to lose your investment without causing a major financial burden on yourself and family), transit-related real estate investments may be appropriate for your financial portfolio. This is particularly the case in joint development projects because, as an investor, you are investing in people's ability to bring a project from concept to reality. You are investing in a financial pro forma of "what may occur" if all the financial and marketing assumptions underlying your financial projections are correct.

STEP 3. DETERMINE YOUR TIME COMMITMENTS

a. Do you have time to follow your local political scene regarding transit-related real estate development?

b. Do you have time to investigate transit-related real estate investment opportunities?

c. How much time can you devote to identify, organize and manage the human and financial resources necessary to take advantage of a joint development opportunity?

d. What adjustments to your schedule can be made to allow you to spend the time in more fully participating in this joint development opportunity?

A real estate development investment involves much more than the placement of investment funds. Depending on the investor role you choose in the project (i.e. developer, initial equity investor, limited partner, etc.), your time commitment can vary from that of a full-time active participant to that of a passive investor.

STEP 4. IDENTIFY POTENTIAL INVESTMENT ASSOCIATES

a. Do you know other friends and associates who have a similar interest in transit-related investments?

b. Can you identify individuals who are experienced and knowledgeable in real estate development or joint development?

c. Do you have established business relationships with local lending institutions which can assist you in identifying and securing financing?

Given the special characteristics of joint development projects, DBEs must recognize the necessity to complement their skills and financial resources with others of similar financial objectives. Bringing together the right group of investors and development experience is an essential prerequisite. Without the financial resources or the development experience to pursue joint development equity opportunities, DBE equity participation is near impossible.

B. The Real Estate Investment Life Cycle

The real estate investment life cycle divides real estate investments into three distinct stages: (1) Origination, (2) Operation, and (3) Termination. Each stage of the investment cycle offers unique financial benefits and risks. With their personal investor life cycle in mind, DBE investors must determine in which stage of the real estate investment cycle (i.e. origination or operation) their personal financial objectives can best be met.

To obtain a better understanding of this real estate investment principle, it may be useful to analyze the "life cycle" of a real estate investment a little closer. During the Origination Stage of a joint development project (usually new construction), the development entity is establishing the financial feasibility of the project, preparing the architectural plans, securing financing and constructing the project. Since the project is not generating income, but rather incurring cost, the financial benefits during this initial period are primarily in the form of tax benefits (i.e. deductions from personal income) to the development entity participants. As such, should you decide to be one of the initial participants in the development entity, your investment is totally at risk. You are investing in your ability and that of your investor group in bringing the project from concept to reality. The financial risks are high, but the financial benefits can be great. In this situation, you must determine the level of financial resources you can place in total risk and you must determine your participation in the project.

Ordinarily, investors most willing to participate in the Origination Stage of a project are in the Growth and Benefit Stages of their investor life cycle.

During the Operation Stage (i.e. project built and generating income), the financial benefits accrue primarily in the form of cash flows and in the form of tax benefits. Cash flow or income generated by the project can be distributed to participants after debt financing and operating expenses are covered. Further, both cash flow and tax benefits are distributed to equity participants according to their prearranged ownership structure of the project. Based on your capabilities and financial objectives, you may decide to take a limited equity ownership* role in the Operation Stage. The decision to invest may be made after the "development rights" to the site are secured by the initial development entity. Under this scenario,

---

* In order to raise the necessary equity capital, a development entity will usually seek out limited equity investors. For their investment, the investor is usually offered a certain <u>proposed</u> rate of return on the investment, liability limited to the amount of the investment and freedom from management responsibility.

phase of the Origination Stage. The actual commitment of funds is usually made contingent on final approval of permanent financing (NOTE: Permanent financing is normally approved only after the project is built and has received a certificate of occupancy). In this manner, your investment avoids the uncertainty of the Origination State.

The Termination Stage in the real estate investment cycle is the point where investors obtain their final return on their investment (i.e. equity build-up and appreciation). These financial benefits are achieved as a result of selling or refinancing* the project. At this stage, the project investors can accrue two important benefits. First, if the project is sold after one year, the profits generated are taxed at a lower level (capital gains rate). Should the investors decide to refinance the project, any profit made from such refinancing is normally tax free.

Illustration III.D provides a schematic presentation of the possible financial benefits accruing to a "hypothetical" DBE development entity composed of a developer/equity investors and limited equity investors.

Illustration III.D

FINANCIAL BENEFITS OF SELECT EQUITY PARTICIPANTS
THROUGHOUT THE REAL ESTATE INVESTMENT CYCLE

EQUITY PARTICIPANTS	ORIGINATION	OPERATION	TERMINATION/
Developer or Developer Group	Developer's Fee** Tax Shelter	Management Fee Tax Shelter Cash Flow Other Fees	Profit from Sale Or Refinancing
Initial Equity Investors	Tax Shelter	Tax Shelter Cash Flow	Profit from Sale Or Refinancing
Limited Partner Investors (passive investors)		Tax Shelter Cash Flow	Profit from Sale Or Refinancing

*Under the current tax structure, the cash flow (i.e. income to investors) usually exceeds the tax benefits seven (7) to ten(10) years into the Operation Stage. At this point, it is in the best interest of the investors to either sell or refinance the project.

**In most major real estate development projects, the developer has an equity share in the project. Since there is no income being generated by the project during the Origination Stage, the developer, as an equity participant, receives tax shelter benefits only. As an active manager in bringing the project to reality, the developer also receives a "fee" for his efforts. The amount and timing of this fee is a negotiable matter among the project owners.

Several caveats apply to the above chart. Since real estate development can involve a variety of private sector participants, the chart describes only the most common and simple development entity compositions. Again, almost every aspect of equity ownership in real estate development is negotiable. There are no set patterns for allocating financial benefits among private sector participants. It is nevertheless important that all participants understand what type of financial benefits can be expected at different stages of the investment cycle.

C. The Ownership Life Cycle

The ownership life cycle has become a very popular way of describing the anticipated costs and benefits of an investment over the expected ownership period. While an ownership life cycle can conceivably cover the entire life of a real estate asset (from construction to demolition 40 to 50 years later), it generally encompasses a much shorter time span. The ownership life cycle, under current economic conditions and tax laws, usually varies from one to ten years depending on the financial objectives of the equity owners.

Within the expected ownership period, all anticipated financial benefits can be calculated for each stage of the real estate investment cycle. The steps used in leading to an investment decision are summarized in Illustration III.E.

Illustration III.E

SUMMARY OF OWNERSHIP LIFE CYCLE FINANCIAL ANALYSIS

STEP 1: **PROJECT CASH FLOW AND AFTER-TAX INCOME THROUGHOUT INVESTMENT CYCLE**

INVESTMENT CYCLE INPUTS

ORIGINATION	OPERATIONS	TERMINATION
The investment	Scheduled gross returns	Net sales price
Tax structure	Effective revenues	Taxable income
Financing	Operating expense	Tax on sales income
Total investment	Operating income	Use of funds
After-tax investment	Debt service	Loans
Sources of funds	Tax effects	
ESTIMATED RETURN SCHEDULE		
Cash flow	Cash flow	Cash flow
Tax effect	Tax effect	Tax effect
Total current benefit	Total current benefic	Total current benefit

STEP 2: **MEASURE PROFITABILITY AND RATES OF RETURN**
Using the estimated return schedule in Step 1, calculate the profitability, rate-of-return estimates, risks and sensitivity to changes in assumptions.

STEP 3: **THE INVESTMENT DECISION**
The decision to purchase, negotiate, or reject is based on Step 2 and factors such as: potential for increased income, alternative financing, reallocation of risks, etc.

In Step 1, projections of cashflow and after-tax income must be calculated for each phase of the investment cycle. This is absolutely critical for all equity and debt participants in the proposed project. DBE development entity participants need to know their projected costs and benefits at each phase of the project. Similarly, limited partners and other equity investors need to know how to compare this specific real estate investment with other competing investment opportunities. Last but not least, the permanent lender needs to know what net operating income (NOI) to expect for repayment of the long-term loan.

In Step 2, the base data developed in Step 1 is transformed into different measures of profitability to satisfy the internal criteria of the various investors.*

Step 3 is the decision point. One of two things can happen at this point:

- Based on the data developed in Step 1, all parties are pleased with their <u>potential</u> return on investment; or
- Based on the data of Step 1, all parties are not pleased with their <u>potential</u> return on investment; and therefore, an adjustment must be negotiated among the participants.**

The ultimate purpose of Step 3 is to come to an investment decision. The important point to understand here is the emphasis placed on <u>assumptions</u>. All parties are making investment decisions based on financial projections derived from assumptions about the marketability of the project, total cost of the project to build, expected revenues, and eventual sale price one to ten years in the future.

---

*Each investor must compare competing investment opportunities with their own financial objectives and their acceptable levels of risks. A simple rule of thumb for comparing investment opportunities is to use the after tax return on low risk investments such as Treasury Bills, money market funds, municipal bonds, etc. as a bench mark. If the proposed after tax return of a real estate investment can substantially increase your return given an expected risk, real estate investments may be right for inclusion in your financial investment portfolio.

**The data developed in Step 1 can be modified by changing the assumptions, changing the design, changing the basic relationship among the participants, and/or getting new participants with different profitability criteria.

VII. CHOOSING THE RIGHT TYPE OF EQUITY OWNERSHIP

We now come to the heart of the matter - the selection of the proper legal form of business organization.

The importance of the legal business organization form of the investment cannot be over-emphasized, because to a great extent the organizational form dictates the level of debt possible in relation to equity. Moreover, selection of an appropriate ownership vehicle can substantially influence the control on the investment by the investor, his/her personal liability, income tax benefits, and the ability to transfer or use ownership interests as collateral. Consequently, the following factors must be considered when selecting an appropriate ownership vehicle:

- nature of the property;
- risk associated with the venture;
- financial resources of the investor;
- amount of liquid investor assets (i.e. cash);
- desire to maximize tax benefits;
- desire to reduce personal liability; and project.
- desire to manage the construction and operation of the project.

A. Selected Real Estate Investment Ownership Forms

Illustration III.F provides a summary of the features of the most commonly used forms of ownership for real estate ventures. Each form of business organization offers a unique set of characteristics which addresses the above stated factors to varying degrees. Of these ownership forms, the three most common ways of taking ownership of real estate are: corporately, individually or with others in general partnership, or in a limited partnership. DBE investors are well advised to seek the advice of a tax accountant and an attorney specializing in real estate ventures before entering into a legal agreement to invest or participate in a joint development equity ownership opportunity.

[illegible]

[illegible]

B. Syndications

Syndications are a very important form of group ownership deserving of special attention by DBE investors. The concept of syndications was introduced in Chapter Two as a potential strategy for DBEs to participate as passive investors in a joint development equity opportunity. Basically, a syndication may be thought of as a mechanism through which equity capital is raised. The organization of investors and management of the investment (i.e. state and Federal reporting requirements) is handled by the syndicator, who often is a general partner in the syndication. At minimum, a syndicator should have the following credentials:

- knowledge of real estate;
- knowledge of the joint development property being syndicated;
- understanding of real estate finance;
- some knowledge of construction, management, and marketing;
- understanding of the local market in and around the site;
- good comprehension of current income tax laws;
- network of contacts among lenders and financial institutions; and
- a good "track record".

The business form these syndications take varies according to the nature of the property, its economic value, the necessary equity monies to be raised, and the financial strength and desire for tax shelter or risk minimization by the investors. Based on these considerations, an appropriate legal entity is selected to accomplish the investors intended purpose. The syndicator then does the following:

- Prepare the "offering" in accordance with the rules and regulations set forth by the Security and Exchange Commission (SEC)*;
- Sell participation in the venture to raise equity capital;
- This equity capital is then leveraged with debt financing to obtain all of the money needed to undertake the joint development project.

*The Security and Exchange Commission is a U.S. government regulatory and enforcement agency which supervises investments, trading activities and administers securities statutes. Real estate investments are considered to be "securities".

It is important to note that an investor in a syndication may be subject to SEC securities regulations. Before investing in a real estate syndication, the DBE investor should carefully review the rules and regulations set forth by the SEC. In particular, Regulation D of the SEC defines an "accredited investor".*

Registering a syndication offering is very complex, expensive and time consuming. There are two major exemptions to registering a syndication offering with the SEC. They are (1) a private offering or (2) an intrastate offering. A private offering exemption is one in which there are fewer than 35 investors who do not meet the test of "accredited investor" as defined by Regulation D of the SEC. Additionally, the use of general solicitation or general advertising for investors is prohibited by the private offering rule. Very important, the private offering rule does not eliminate or reduce the responsibility of the syndication to full disclosure all risks associated with the project. DBE investors should insist that syndicators follow the disclosure guidelines of Regulation D of the SEC in preparing the prospectus for the protection of all.

In order to meet the intrastate offering exemption, all of the following tests must be passed if the offering is to escape jurisdiction under the intrastate exemption:

1. The issuer (limited partnership or corporation) must be formed under the laws of a single state.

2. All of the limited partnership interests or corporate shares must be sold and offered to residents of the same state. Note that if a single nonresident is offered or buys a single security, the exemption is lost. The use of nominees to disguise the fact that a real buyer is a nonresident will not help you. Also, sales to residents who then resell to nonresidents make trouble for you. Indeed, any resale to a nonresident within nine months of the date of the last sale of the offering will disqualify the exemption.

3. The issuer must be a resident of the same state in which the securities are being offered.

---

* An <u>accredited investor</u> is, in short, an investor who is too smart or too wealth to require SEC protection. The SEC has eight categories of accedited investor ranging from institutional investors to the test for individual income. For example, there is the "Two Hundred Thousand Dollar Income Test". This test requires that the investor must have an income in excess of $200,000 in each of the last two years preceding the purchase of the securities and who reasonably expects an income in excess of $200,000 in the current year.

4. At least 80 percent of the issuer's assets must be located within the same state as the investors and offerees. Also, the issuer must derive at least 80 percent of its gross revenues from within the state, and at least 80 percent of the proceeds derived from the offering must be used within the state. In other words, the property, the investors, and the syndicator all must be located within a single state to escape SEC jurisdiction under the intrastate exemption.*

As may be seen from this brief discussion on syndications, syndications are complex legal and financial transactions. Nevertheless, with proper preparation and professional counsel, syndications can offer an excellent way for DBE's to participate as passive equity owners in joint development projects.

The importance of professional advice in transit-related real estate investments is paramount. With few exceptions, joint development projects are intangible in the sense that the proposed project does not exist. You are investing in an "idea". Bringing that idea from concept to reality depends on your ability to estimate the following: the marketability of your idea; the total cost of constructing your idea; the gross income and operating expenses of your idea; and, the expected economic returns of your idea. Given this task, it behooves you to minimize the uncertainty and financial risks of this proposed idea by soliciting the assistance of professionals experienced in bringing real estate investment ideas from concept to reality.

The principal purpose of this chapter was to raise questions which make you <u>think</u> about real estate investment decision-making. It is your responsibility to refine these investment decisions and seek the assistance of experts to evaluate the options available for maximizing your return on investment of money, time and human resources.

*Berman, Daniel, S., How to Put Together a Real Estate Syndicate or Joint Venture, page 100. DBEs are encouraged to read this book and others on the subject of syndications.

CHAPTER FOUR

HOW TO GET YOUR PROJECT TO THE DEAL-MAKING STAGE AND BEYOND

OVERVIEW

Let us now review what the manual has attempted to accomplish thus far:

- The manual began by defining joint development as both a public/private sector decision-making <u>process</u> and as a real estate <u>product</u>. The benefits of DBE equity ownership were described as well as the traditional barriers to DBE equity participation in joint development opportunities;

- Chapter Two examined the joint development process. Emphasis was placed on the interaction between the public sector development policies and the private sector investment objectives leading to a deal-making environment. Within this framework both the public and private participants negotiate "development rights and legal commitments"; and

- Chapter Three focused on joint development as a real estate product. As a real estate product, DBE equity ownership in joint development is an investment requiring an investment decision. This investment decision must take into consideration both the unique nature of transit-related real estate development opportunities and the "readiness" of DBEs to take advantage of the financial benefits and risks associated with equity ownership.

This chapter is designed to show DBEs how a real estate development project is put toge[illegible] it is analyzed; and how

it is packaged to obtain financing. Emphasis is placed on the type of information needed to make discrete yet cumulative decisions leading to a transit-related real estate investment decision. To this purpose, the chapter is divided into two major parts:

I. How a Real Estate Development Project is Put Together

II. How to Undertake a Preliminary Economic Feasibility Analysis

I. HOW A REAL ESTATE DEVELOPMENT PROJECT IS PUT TOGETHER

The life cycle of any real e te development project includes its planning or <u>origination</u>, the ongoing <u>operation</u> and eventual sale/refinancing or <u>termination</u>. To understand how real estate development projects are put together, DBEs must go beyond these generalities and break down each stage of the investment cycle into distinct phases to examine the discrete investment decisions which must be made. Collectively, these phases are commonly referred to as the "real estate development process." Illustration IV.A describes this interrelationship.

Illustration IV.A

INTERRELATIONSHIP BETWEEN THE REAL ESTATE INVESTMENT CYCLE AND THE REAL ESTATE DEVELOPMENT PROCESS

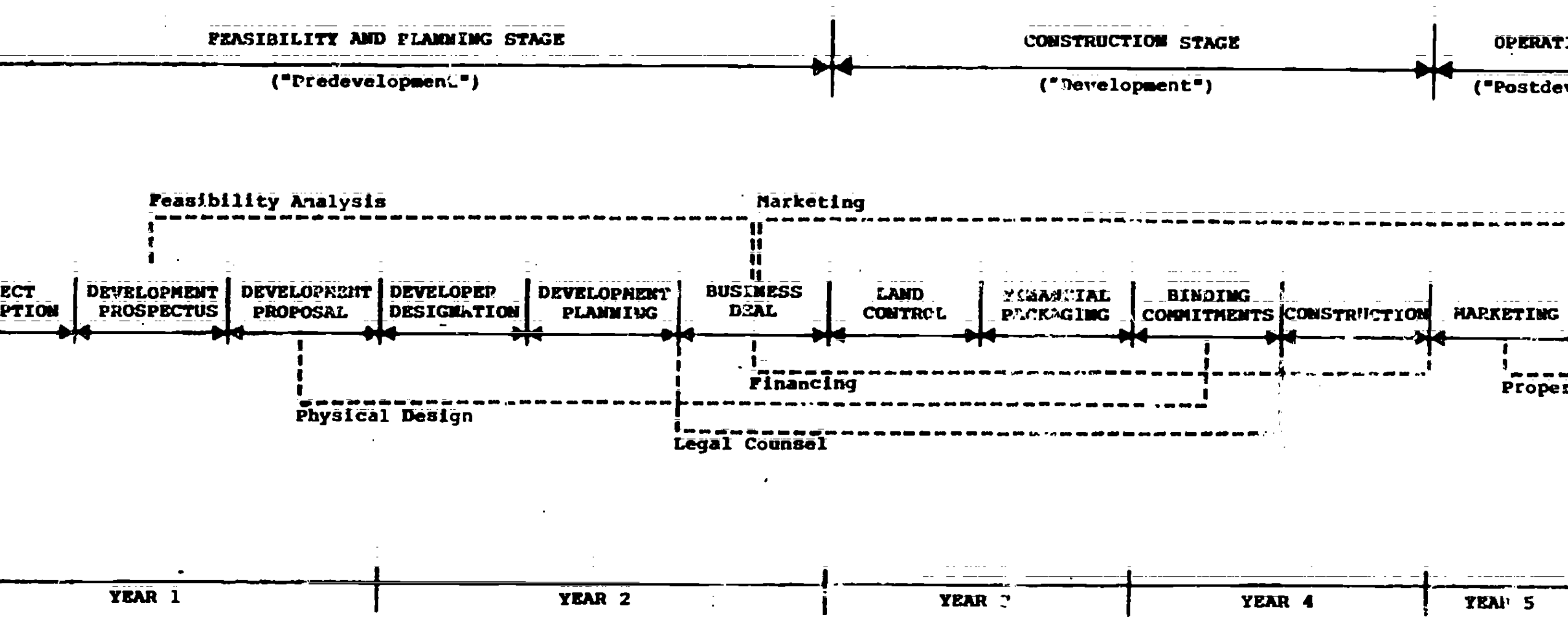
REAL ESTATE INVESTMENT CYCLE	ORIGINATION STAGE	OPERATION STAGE	TERMINATION STAGE
Real Estate Development Process	Concept Phase asibility Phase al Design Phase ancing Phase ruction Phase	Operation Phase	ermination Phase

In regard to joint development projects, the development process "phases" may be arranged slightly differently to reflect the <u>co-development</u> involvement of the public and private sector participants. As portrayed in Illustration IV.B, this rearrangement begins with the public sector being the initiator of the Concept Phase (i.e. project conception). Both the public and private sector participants share in the Feasibility Phase decision-making. Since the Concept and Feasibility Phases lead to the selection of a developer, these phases are referred to as "Predevelopment". The public sector's planning and design criteria may also influence how the developer undertakes the engineering and architectural/physical design of the project (i.e. Final Design Phase). Participation of the public sector in the Financing Phase is a possibility in some situations. The Construction Phase may require coordination with the public sector's own construction schedule. Together the Final Design, Financing and Construction Phases are combined into the "Development" stage. Lastly, Operation and Termination Phases are called "Post Development" and may involve public/private management of the project.

It should be noted that the phases within the co-development

ILLUSTRATION IV.B

THE CODEVELOPMENT PROCESS



The sequence above is substantially simplified, since individual steps (denoted by solid lines) may occur in a somewhat different order, and often merge and overlap in time. Moreover, certain activities such as feasibility analysis and physical design (denoted by dotted lines) continue through several steps in codevelopment. Finally, the time required for codevelopment is highly variable and depends upon a project's complexity, public review procedures, etc.

Source: Gladstone Associates.

process, as with the traditional real estate development process, overlap. This is often necessary and desired in order to maintain a continuous and integrated flow of activities leading to the timely construction and operation of the project.

Furthermore, irrespective of how a particular public or private sector entity breaks down the phases of the real estate development process, all real estate development projects must address the discrete investment questions posed by each phase in addition to undertaking the tasks required by each phase. Let us now examine the activities, financial commitments and human resources needed to perform each phase of the co-development process* leading to a joint development project.

A. Concept Phase

The purpose of the Concept Phase is to define the real estate development "concept". No money has been borrowed. No site has been purchased. No staff resources have been committed. The "concept" definition begins with matching development project ideas with markets, either by selecting an area and searching for development opportunities or selecting a development concept and searching for an appropriate area. This is the idea formulation phase in which concepts are matched to alternative development strategies and specific development goals and objectives.

1. Role of the Local Transit Agency

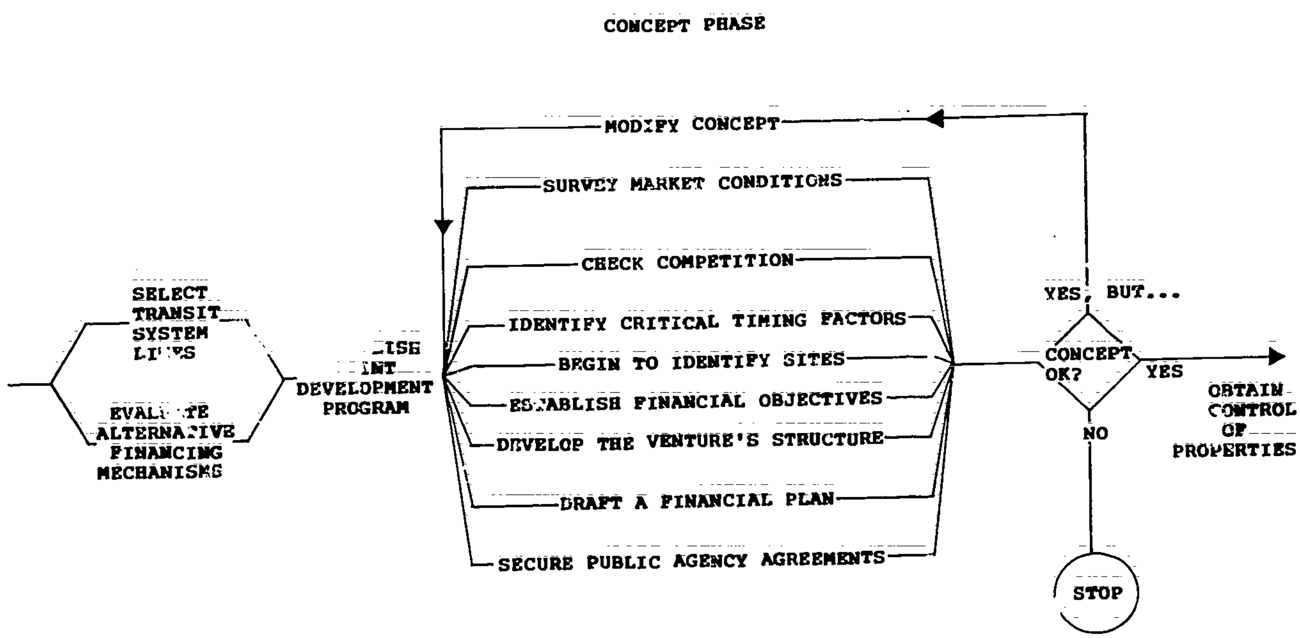
In joint development projects, the local transit agency takes the lead in initiating the Concept Phase. The purpose of the Concept Phase is to identify potential joint development sites along the transit station network. Once a site has been identified through some site selection criteria, preliminary information on land cost, local market conditions, etc. will be gathered to begin to define the "development concept" for each specific joint development site.

In essence, the local transit agency assumes the financial and human resource expense of undertaking the Concept Phase. Additionally during this phase, the sites' "development rights" are acquired (outright purchase or long-term option agreements) by the local transit agency,

*Readers of this manual are encouraged to augment the information presented in this section with extensive reference material found in local libraries and trade association libraries. One of the best sources of information on real estate investments and the real estate development process is the local chapter library of the National Board of Realtors Association in your community.

thereby giving the agency "ownership rights" in determining the future use of these properties. The commitment of public funds for these initial activities may be viewed as seed money to promote transit-related real estate development projects which will provide the transit agency with added sources of revenue. Illustration IV.C provides a graphic description of some of the factors which must be considered in leading to a transit agency's decision in selecting specific joint development sites.

Illustration IV.C



The duration of the Concept Phase may vary. Much depends on the time schedule established for completing various transit lines within the transit system. Some joint development sites may be constructed as the transit system is being built. Other joint development sites may have to lay idle for years until the proper combination of transit services and market conditions emerge to make the project economically viable.

2. Role of the Private Sector

Despite the lead role played by the local transit agency in the Concept Phase, DBEs should not be idle during this phase. DBEs should do the following:

- Conduct their own analysis of the proposed transit system to determine which potential joint development site(s) best meet their objectives;
- Maintain ongoing contact with the transit agency's Board of Directors, policy committees and joint development staff planning activities; and
- Document and update all transit agency land purchases and/or land con[illegible] by the transit agency.

The Concept Phase is also an excellent time for addressing the issue of DBE equity ownership goals as part of the joint development program. DBEs should strive to obtain specific DBE equity ownership policies from the transit agency Board of Directors. Equally important, DBEs should work for the establishment of an implementation plan by which DBE equity ownership goals will be achieved and monitored. Policies without implementation plans are of no value.

B. Feasibility Phase

The purpose of the Feasibility Phase is to determine the chances of success for a specific "development concept" or "building program". As such, the Feasibility Phase is concerned with properly identifying the investment problems, structuring or evaluating objectives (i.e. planning, design and financial requirements) and formulating an acceptable action plan to accomplish these objectives. Furthermore, the actual feasibility analysis is more than a numbers analysis. It is an attempt to subject the proposed "development concept" to rigorous financial and economic market analysis, legal and political feasibility and compatibility with both the public and private sector's objectives.

The definition of the Feasibility Phase presented applies equally to both the public and private sector participants.

1. Role of the Local Transit Agency

For the transit agency, the Feasibility Phase is a time for refining the "development concept" for specific sites. The process consists of maximizing the site's potential (i.e. adequacy of land parcels for development, accessibility, proper zoning, etc.) and neutralizing and minimizing the obstacles (i.e. incompatible land use, unwilling sellers, uncertain local market conditions), in order to attract the right developer and private investment into the project. These pre-development activities not only allow the local transit agency to determine the potential use for the site, but also provide a basis upon which to evaluate the potential financial returns to the agency and the type of financial incentives, if any, necessary for private sector participation. This feasibility analysis results in a "project package".

With this "project package" in hand, the local transit agency can do one of two things. It can negotiate the "project package" with a pre-selected development entity on a non-competitive basis, or it can transform the "project package" into a prospectus* (refer to Chapter II, Section V and VI) and undertake a competitive bid process. In either case, the potential developer or developers must prepare a <u>response</u> to the local transit agency's "project package", which reflects the design parameters and financial return requirements imposed by the agency.

2. Role of the Private Sector

For the private sector, the Feasibility Phase sets the stage for many critical decisions which will guide the project through the investment cycle. During this phase, the following tasks must be accomplished:

- Selection of development entity;
- Commitment of "risk capital";

---

*It is absolutely critical that every effort be made to identify the parameters (i.e. expected financial return to transit agency, proposed highest and best use for site, special architectural design requirements, zoning, etc.) which will be imposed on the joint development site(s). If these parameters are unacceptable, discuss these issues with the local transit agency prior to their preparation of a prospectus. Arguing these issues after the prospectus is on the street more than likely will be fruitless and may jeopardize your development entity's chances to get the "development rights" to the site.

- Conduct a Preliminary Economic Feasibility Analysis;
- Organization of development team; and
- Preparation of feasibility analysis/development proposal.

Each of these tasks has a cumulative affect on the potential success of the development entity to: (1) acquire the "development rights" to a specific site; and (2) accomplish the financial objectives of the real estate venture. For this reason, each of these tasks will be amplified in the following discussion.

a. Selection of the Development Entity

The importance of selecting the right development entity cannot be overemphasized. Without exception, the success of the DBE equity partners depends on their ability to complement their strengths with the financial resources and credibility of individuals with extensive experience in developments similar to that proposed for a specific site. Consequently, the task of putting together a development entity should be done well in advance of the local transit agency's completion of their feasibility analysis on the site your group wishes to acquire. DBEs are strongly encouraged to carefully plan a strategy for identifying and selecting the appropriate individuals for their development entity.

Two things are essential in the selection of a development entity: (1) the ability of each partner to provide risk capital and financing for the project; and (2) the ability of each partner to bring organizational skills and real estate expertise to the project. Potential participants in the development entity must bring one or both of these assets to the table. The greater their contribution to the project, the greater their "interest" in the project. Illustration IV.D describes several factors which the DBE should consider in the selection of development entity partners.

Illustration IV.D

FACTORS TO CONSIDER IN THE SELECTION OF A DEVELOPMENT ENTITY

FIRST: Identify partners who complement your personal resources. If you have risk capital but little experience in real estate development, identify someone with a proven record as a developer. Conversely, if you have experience in real estate development but little money, identify an investor or a group of investors.

SECOND: Identify partners who have dissimilar financial objectives. This will allow you to allocate the various financial benefits to your mutual benefit. Some of the things you should consider are the following:

- Legal constraints on acceptable investments
- Tax law constraints on acceptable investments
- Estate planning objectives
- Diversification requirements
- Passive vs. active management
- Regular income vs. capital appreciation
- Safety of principal vs. potential yield on investments

THIRD: If money is a problem, consider negotiating equity in the project for essential professional services (i.e. attorney fees, architect fees, etc.). But be extremely careful in using this approach. Make absolutely certain you can get these individuals out of the deal if they do not perform. Consult your personal attorney on how to protect yourself in this matter.*

FOUR: Reduce all development entity agreements and specific responsibilities to writing. This will avoid untold difficulties in the future. Secure legal counsel in this matter acceptable to all parties participating.

FIVE: Strive above all else to establish a win-win situation among all development entity participants. All of you will have to live with your investment decision for a long time.

*There is one cardinal rule in real estate development. The longer you and a selected few trusted partners can hold out before bringing in other equity investors during the Origination Stage, the more equity in the project your group will be able to keep for yourselves. Carefully anticipate your "risk capital" and human resources so that you are dealing from a position of strength should additional equity partners be needed.

Once you have chosen your development entity, you and your partners are ready to review the type of human resources and expertise necessary to accomplish the objectives of each phase of the Development Process.

b. Commitment of Risk Capital

During the period the development entity is being organized, concurrent efforts must also be made to secure financial commitments to undertake the project. The initial "risk capital" must come from individual partners of the development entity. These financial resources are termed "risk capital" because there is no guarantee, at this point in the process, that the local transit agency will accept the development proposal (assuming a competitive bid process) prepared by any one of the development entities in competition for the "development rights" to a specific site. It is common for development entities to spend in excess of $100,000 each in the preparation of a competitive bid proposal to acquire the "development rights" on a particular joint development site. Therefore, great thought must be given as to how best to attract this level of initial investment.

There is another important cost which must be incorporated into your "risk capital" pool. As part of the cost of bringing the project through the Financing Phase (i.e. to a point where the project can obtain outside financing), your development entity must be prepared to have sufficient capital to meet all initial deposits and subsequent lease payments imposed by the local transit agency. Additionally, funds must be available to pay for expenses in the Final Design and Financing Phases. By the time the project is ready to obtain the construction loan, the development partners may have as much as $500,000 or more invested in the project as cash or liabilities.

Consequently, the magnitude of financial requirements is a function of the size and complexity of the project. Before pursuing equity ownership in a joint development project, DBEs must have a clear understanding of what financial commitments are necessary; when these funds must be available; and what sources can be expected to provide this financial support. As insurance, it is wise to seek out development entity partners who have sufficient personal financial net worth to sign for guarantees, letters of credit, and loans should the need arise (NOTE: Such guarantees for the development entity partners may require added ownership for those taking the added risks).

c. Conduct the Preliminary Economic Feasibility Analysis

By the time the transit agency has completed its

feasibility analysis and prepared a solicitation, the DBE development entity and some initial risk capital should be in hand. The first task is to conduct a "Preliminary Economic Feasibility Analysis" (see Chapter IV, Section II for details) to determine if this particular joint development equity opportunity is appropriate for your group.

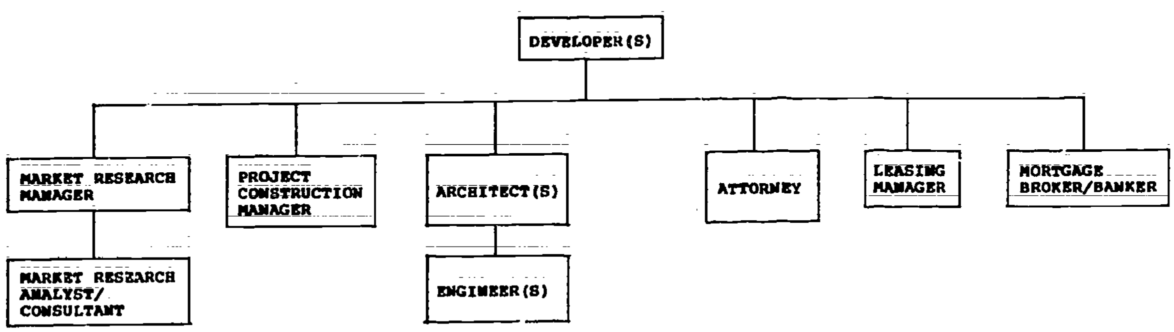
This preliminary analysis is the most important step in the entire Real Estate Development Process. As will be shown in the latter part of this chapter, the preliminary analysis is a low-cost comprehensive approach to evaluating your chances for success. It provides the necessary information by which to make a "go" or "no-go" decision to pursue this opportunity.

d. Organization of the Development Team

Assuming the results of the preliminary analysis were positive and a decision was made to pursue this joint development opportunity, the organization of the development team must be completed. Invariably some of the members of the development team were consulted as part of the preliminary economic feasibility analysis. Now other development team members must be brought into the feasibility analysis and development proposal preparations. Illustration IV.E provides a graphic description of the type of professional expertise needed during the Feasibility Phase.

Illustration IV.E

DEVELOPER/DEVELOPMENT TEAM ORGANIZATION
DURING FEASIBILITY PHASE OF DEVELOPMENT PROCESS



As in the selection of the development entity, the selection of the development team members is critical to winning the "development rights" to a specific joint development site. The development entity's developer must have the experience and personal knowledge to select the right expert for the right job. For example, a certain consultant may have an excellent reputation in preparing financial feasibility studies for commercial office projects but may be an unknown in preparing financial feasibility studies for hotels. With an experienced developer in the development entity, misuse of consultant talents can and must be avoided. For it is the reputation and credibility of the development team members which lend confidence to the feasibility analysis. Without this confidence, the transit agency (let alone the lenders) will be reluctant to seriously consider the development proposal.

e. Preparation of Feasibility Analysis/Development Proposal

In co-development, the private sector's role in the actual Feasibility Phase is to prepare the development proposal submitted to the public agency in response to a solicitation. The details of what is included in this development proposal may vary among transit agencies (refer to Chapter II, Section VI). Therefore, it is important to follow the submission guidelines set forth in the prospectus. At some point, a detailed feasibility analysis will have to be undertaken in support of the development proposal. Although the degree of emphasis depends on the objectives to be accomplished, all feasibility analyses are made up of similar components.

- **OBJECTIVES:** The development entity must outline all the public/private objectives to be achieved. Problems and constraints regarding the achievement of these objectives must be clearly defined. This is extremely important because the definition of the problems will predetermine the solutions and alternative strategies available.

- **PROJECT DESIGN:** The propos... ...ding program" must reflect the planning, design, ... financial requirements set forth by the transit agency. The final commercial mix in the project will be dictated by the local market demand. Schematic architectural drawings of the proposed "building program" must be prepared as part of the submission.

- **MARKET STUDY:** The identification of market trends is necessary to develop alternative approaches to

contingencies in permanent financing be negotiated fully and to the mutual satisfaction of everyone involved.

ii. Construction Loan Closing

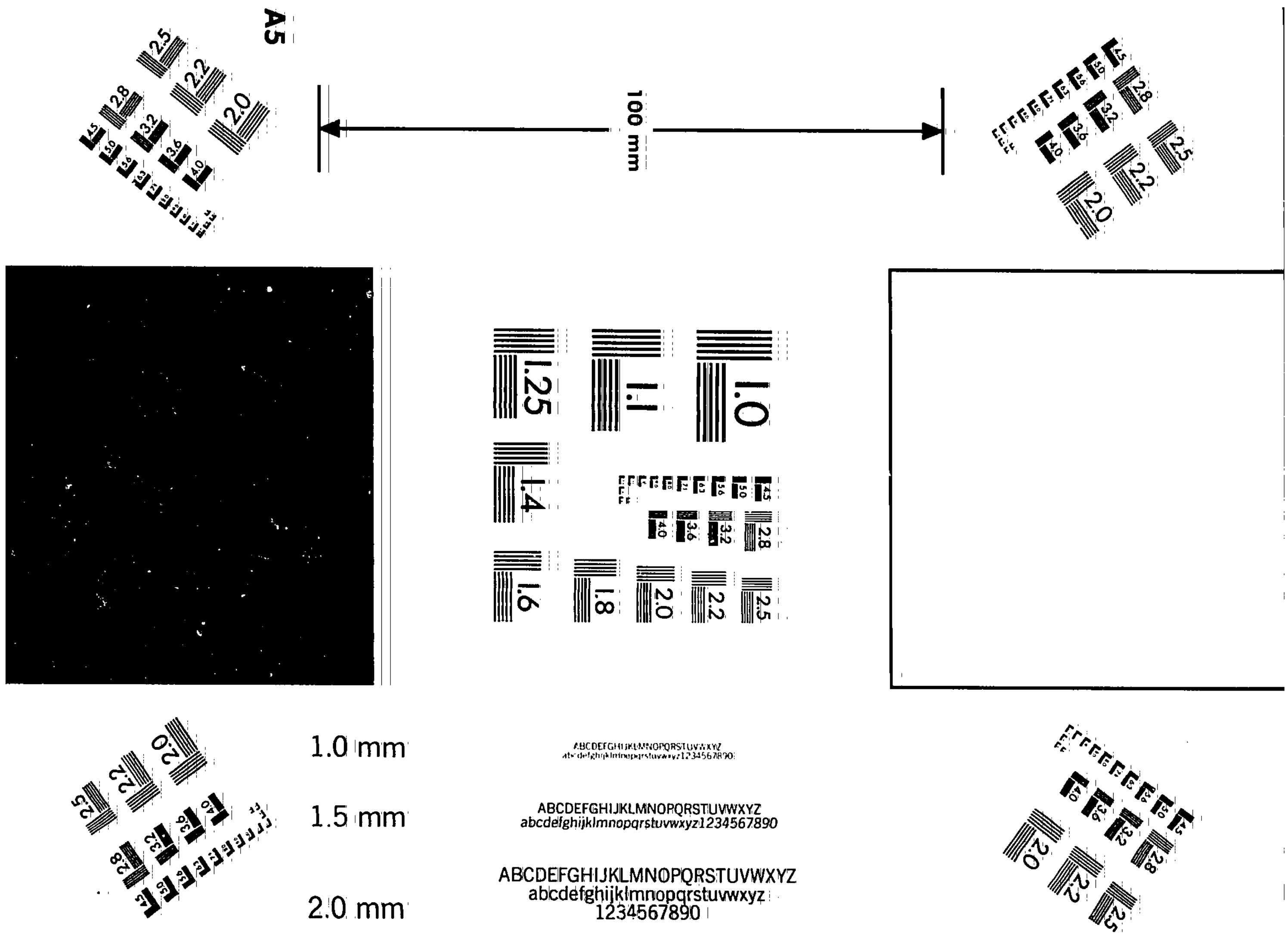
As mentioned earlier most construction loans are made once assurances of permanent financing are obtained by a development entity. Further, most construction loans are secured by a mortgage for future advances. Essentially this means that the construction lender has a first lien on the land and all subsequent improvements as funds are disbursed for materials and labor used in the construction of the project.

Construction financing poses special risks to a development entity, in particular, one with little development experience. For example, construction may be slowed down as a result of inclement weather or labor strife. If a slowdown occurs, interest charges, overhead, and real estate taxes can accumulate. This may require that your development entity invest additional equity funds or that the bank increase the loan over the initial amount of the construction loan commitment. Another area of risk lies in the possibility of poor construction management as a result of a firm's inexperience in a particular field of construction. These conditions can lead to cost overruns and delays which can threaten the financial viability of the project.

A further consideration in negotiating a construction loan relates to the take-out commitment of the permanent lender. You may recall that most take-out commitments usually have contingencies attached.

Due to the various risks associated with the construction of a project it is common practice for the construction lender to review your financial and marketing plans with great detail. In general, the construction lender will review the financial and marketing plans of your development entity to determine how much should be loaned based on the economic value of the project. Normally, the construction loan will be made for the hard project costs. The construction lender will also perform a detailed ratio analysis of projected operating statements to determine if the assumptions made conform with local economic conditions. After this detailed analysis is completed the construction lender will make a final determination as to whether the project should be financed.

Once you have received a commitment from a construction lender the closing of the loan is the next


A5
100 mm
1.0
1.1
1.25
1.4
1.6
1.8
2.0
2.2
2.5
2.8
3.2
3.6
4.0
1.0 mm
ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890
1.5 mm
ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890
2.0 mm
ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz
1234567890

accomplishing the stated objectives. The strength of competitive suppliers or users must be examined to determine whether the market can easily absorb the proposed "building program".

- **COST ANALYSIS:** The project cost must be determined with the assistance of the developer, architect, construction contractor and the mortgage banker.

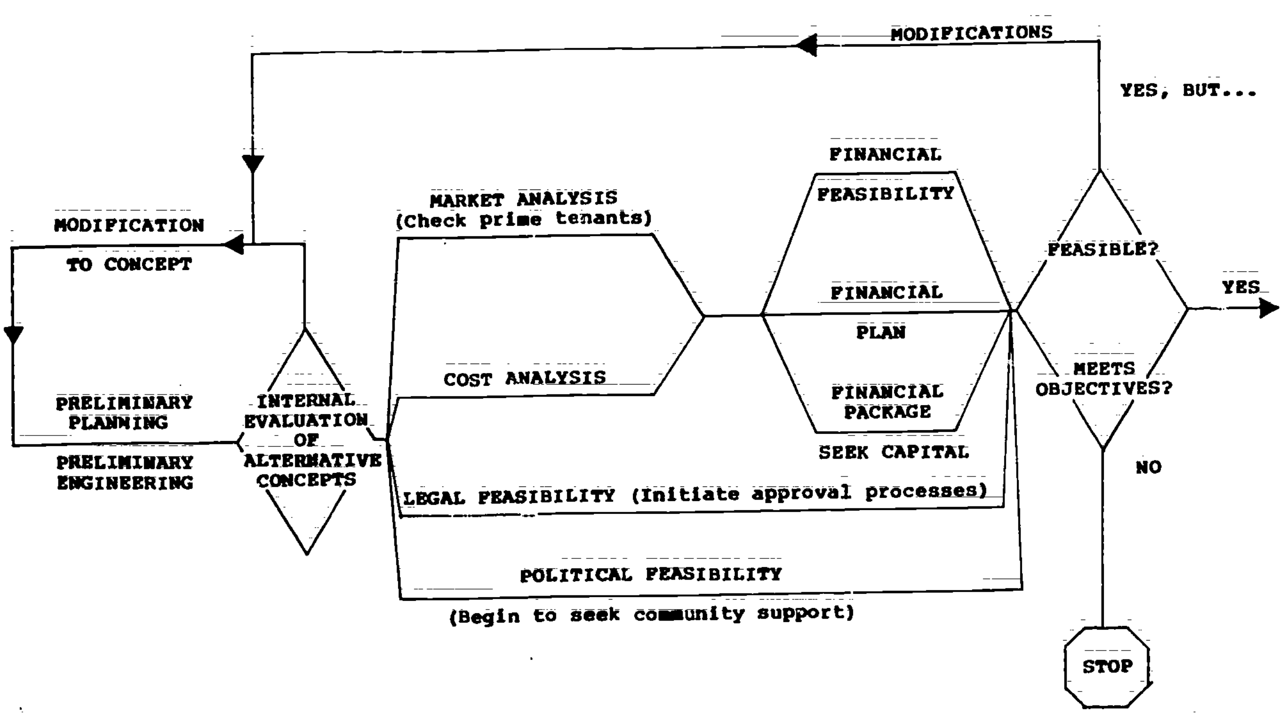
- **FINANCIAL FEASIBILITY:** The financial feasibility will identify all revenues and expenses broken down into several categories based on alternative occupancy rates supported by the market analysis. A financial plan (including pro forma balance sheet and cash flow analysis for a ten (10) year period) is prepared, packaged and used to seek capital for the project.

- **POLITICAL/LEGAL FEASIBILITY:** The development entity must carefully review the transit agency's commitments. All legal constraints, if any, must be examined. All pertinent governmental agency coordinations and restrictions must be reviewed to include comprehensive land use plans, capital improvement plans, major street plans, etc. Familiarity with transit agency regulations on zoning and building codes is essential.

llustration IV.F graphically describes how the components of the feasibility analysis interact and lead to a decision regarding the potential feasibility of the project.

Illustration IV.F

FEASIBILITY PHASE



Once the feasibility analysis is completed, it must be integrated into the development proposal requirements set forth in the transit agency's prospectus (refer to Appendix Four for an example of a joint development prospectus).

The importance of the Feasibility Phase to successfully acquiring the "development rights" to a specific joint development site cannot be overemphasized. The proposed building program must be economically feasible in meeting the financial objectives of all investors and the transit agency. The feasibility analysis' conclusions must be supported by independent and reputable consultants. The development entity must also demonstrate its financial and managerial ability to build the project. Furthermore, the proposed development team (i.e. architect, contractors, leasing agents, etc.) must be credible to the local transit agency, lenders and potential future equity investors. Conditional letters of financial commitments from permanent lenders and equity capital sources must be included in the proposal. Care must be taken to address every detailed requirement of the request for proposal. Most importantly, rehearse the presentation before going to the local transit agency review board should your proposal be one of the finalists selected. Know who will review your proposal. Last but not least, bring your best negotiators to the deal-making table when the time comes.

C. Final Design and Financing Phases

Upon award of the "development rights" to a specific joint development site, your development entity must begin the Final Design and Financing Phases. The purpose of the Final Design Phase is to finalize all prerequisite studies, architectural and engineering plans, financial projections, and legal documents necessary to obtain permits to build the project and to secure financing (equity and debt capital) to build the project. The purpose of the Financing Phase is to integrate the final products of the Final Design Phase into a marketable package to attract anchor tenants, solicit new equity investors, and secure construction/long-term financing for the project.

The activities of both the Final Design and Financing Phases are interdependent and, as such, address similar issues and concerns. Consequently, both of these phases are presented together in this section.

1. Role of the Local Transit Agency

The role of the local transit agency in the Final Design Phase varies by project and circumstance. In a situation where the joint development project is implemented after the completion of the transit station, the transit agency may only have to monitor the developer's compliance with the planning and design requirements of the joint development agreement. The matter is complicated if co-construction of the transit station and the joint development project is contemplated. In this latter situation, both the transit agency and the development entity must coordinate their respective design components, construction schedules, etc.

The local transit agency would enter the investment decisions of the Financing Phase only if 1) the selected development entity is unable to secure financing under the terms and conditions of the agreement; or 2) the transit agency has committed certain financial incentives as part of the private investment arrangements. In the former situation, the transit agency may either modify the financial terms and conditions or terminate the agreement and seek a new development entity. The latter situation is a matter of working out the details of the public financial contribution.

2. Role of the Selected Private Sector Development Entity

The development entity's developer takes the lead role in accomplishing the activities of these phases of the real estate development process. Specifically, the developer must undertake the following interdependent activities:

Final Design Phase

- Coordination and scheduling of overall project management plan;

- Supervision and preparation of all architectural and engineering plans and specifications;

Financing Phase

- Reassessment of feasibility analysis and complete leasing strategy;

- Identification and negotiation of additional equity capital; and

- Identification and commitment of debt financing.

Before discussing these major activities, it should be noted that the primary source of funding to perform the Final Design and Financing Phases* must also come from the "risk capital" pool of the development entity. Emphasis is placed on the <u>risk</u> nature of the investment because, despite the fact the development entity now has the "development rights" to a specific site, many of the critical elements of the project (i.e. architectural plans, financing, ownership structure, etc.) have yet to be committed or finalized. Nevertheless, there is some reasonable expectation, based on the results of the Feasibility Phase, that if the project is properly organized and executed, the chances of successfully completing these phases are good. It is precisely at this point that an experienced developer becomes an invaluable asset to the development entity.

a. Coordination and Scheduling Overall Project Management Plan (Final Design Phase)

The overall project management must now be finalized. The developer must undertake the critical task of

*In the Financing Phase, great caution must be taken to avoid the small percentage of unscrupulous money brokers who will claim to deliver financing for an up-front fee. Better to identify well-established sources of capital, mortgage bankers and lenders, than to pursue exotic sources of financing. Properly planned, the Financing Phase should require little if any up-front expenditure of your limited risk capital pool beyond that required to accomplish the activities of the Final Design Phase.

coordinating and scheduling the various staff and consultants to complete the various prerequisite activities needed to prepare the plans and documents of the Final Design Phase. These products of the Final Design Phase must be integrated and/or modified into several marketing packages to attract anchor tenants, solicit equity capital, and secure construction and long-term financing for the project. Items which should be considered in the preparation of the final overall program management plan are the following:

- Reevaluate the role of the development entity partners based on their performance during the preparation of the development proposal and subsequent negotiations with the local transit agency, and modify roles accordingly*;

- Reevaluate the performance of the development team members to deliver in the preparation of the development proposal and make final substitutions and/or additions to the development team*;

- Schedule of all product deliveries should be set, deadlines established and priorities agreed upon (detailed documentation and requirements of all activities in schedule should also be developed);

- Reevaluate change of command and areas of responsibility for all development entity partners and development team members; and

- Establish administrative and fiscal procedures and responsibilities.

These considerations should be part of an overall project management plan. The need to plan and organize the execution of the project is critical to the success of the project.

---

*There is no better way to test the competence of a partner or consultant than their performance under fire. The Feasibility Phase just completed provides excellent data for evaluating the strengths and weaknesses of the development entity's partners and development team members. If changes must be made, they must be made at this point. No project exists. Project liabilities are at a minimum. From this point onward in the real estate development process, it will become extremely difficult to make changes to the development entity and the development team.

b. Supervision and Preparation of all Architectural/Engineering Plans (Final Design Phase)

Without the architectural and engineering plans, there is no project to fund.* The construction lender will need to see all final plan documents and building permits before funds are released to build the project. Since the architectural design and engineering plans are reimbursable expenses from the construction loan, the development entity normally pays a "negotiated" portion of the architectural and engineering plans as they are prepared from the "risk capital" pool.** Included in the preparation of the architectural and engineering plans are the following:

- Definition of property operations and management requirements in project physical design;
- Definition of property operations, management, maintenance and security requirements;
- Preparation of complete architectural and engineering design and working drawings for construction approvals by lenders, investors, anchor, and key tenants;
- Preparation of complete construction contract bid packages;
- Preparation of a "final" floor plan, and merchandising plan; and
- Obtain building permits.

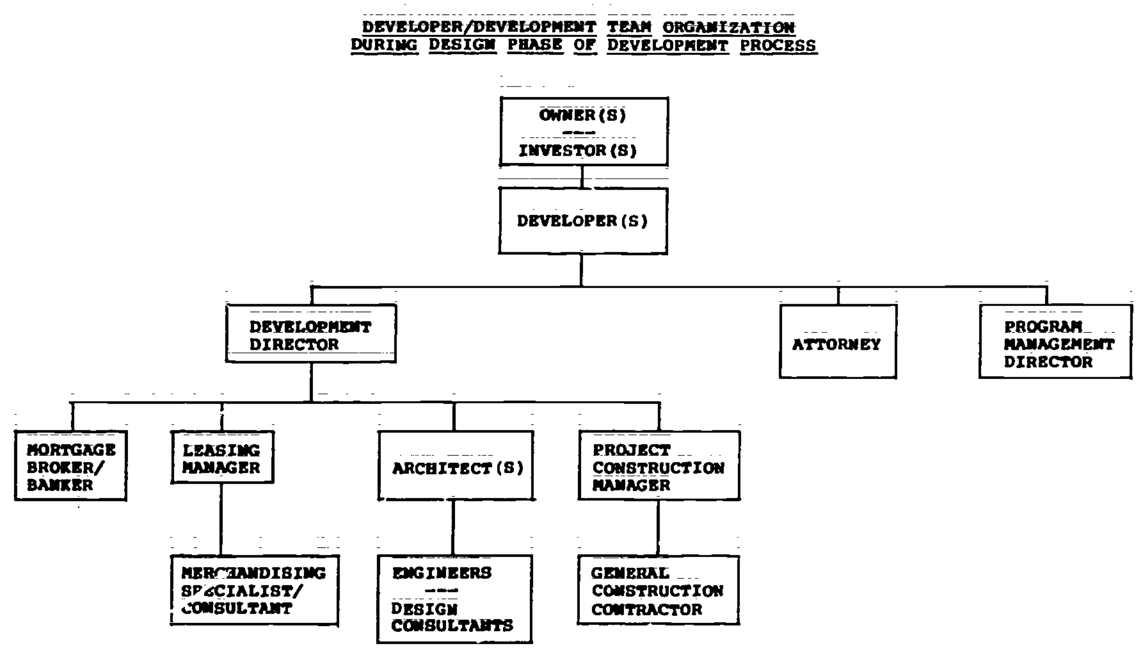
---

*In some situations (especially where lenders are participating as equity partners in the project), the final architectural/engineering design costs are paid from the construction loan proceeds as the plans are being produced. In such cases, the building permits, title search and permanent financing commitments obviously must be obtained prior to the Final Design Phase.

**One common way of minimizing out-of-pocket cost during the Final Design Phase, is to negotiate reduced up-front fees with firms or individuals providing professional services (i.e. architect, general contractor, attorneys, etc.) in exchange for equity in the project. Be careful in using this cost reduction approach and avoid it if possible. Remember, the development entity still has to raise additional equity capital to meet the lending requirements of the construction and permanent lender. Depending on the negotiated contractual arrangements with your professional consultants and size and complexity of the project, the Final Design Phase may require an additional $200,000 to $500,000 or more depending on the scale of the project.

The completion of these activities requires the participation of various consultants. Illustration IV.G graphically depicts the development team needed in this phase.

Illustration IV.G



c. **Reassessment of Feasibility Analysis and Complete Leasing Strategy (Financing Phase)**

The Financing Phase really began as part of the Feasibility Phase. Your development entity would never have committed the "risk capital" to prepare the development proposal unless there was some reasonable chance to attract equity capital and long-term financing. Now your development entity must transform these reasonable chances for financing into binding commitments from specific equity investors and lenders.

The market study and financial plans (i.e. project cost, pro forma cash flow prospectus, assumptions about the local market, etc.) submitted as part of the development proposal to the local transit agency must be reevaluated. This is especially important if the initial studies and financial plans are over one year old. Modifications should be made by the original consultants* who prepared the studies or the financial plans.

Along with the reassessment of the feasibility analysis, the developer must complete the leasing strategy for attracting anchor and key tenants. This leasing strategy should include the name of the leasing agency, detailed description of marketing plan, list of potential tenants, leasing schedules and commission arrangements. Ideally, the developer should have a firm commitment from an anchor tenant** to include as part of the project package submitted to potential equity investors and lenders.

d. **Identification and Negotiation of Additional Equity Capital (Financing Phase)**

In the preliminary economic feasibility analysis, as part of

---

* Of all the consultants on the development team, the financial feasibility and market study consultants are <u>critical</u> to the confidence investors and lenders will place on the economic viability of the project. DBE development entities are strongly encouraged to hire financial/marketing consultants known and respected by local banks and potential long-term lenders.

**In the rush to get firm commitments from an anchor tenant (i.e. major hotel, regional department store, etc.), be careful to avoid situations in which the anchor tenant dictates the terms of the lease or requests an equity position in the project. These arrangements may be satisfactory if and only if they are acceptable to all equity investors and permanent lenders. It is better to hold off from entering into a sweetheart deal with a potential tenant until all sources of financing have been identified. All potential financial participants in the project should be aware of all financial implications affecting the return on their investment.

the Feasibility Phase, the amount of equity capital needed was determined. Now the developer must reevaluate the best sources for equity capital. These sources include, in order of priority: (1) the project's development entity; (2) limited investors known by the developer or development entity partners; (3) limited investors organized by a syndicator; and/or (4) the permanent lender.

Collectively, the partners of the development entity may have the equity capital necessary to satisfy the loan-to-value requirements of the permanent lender. If the development entity partners contribute additional equity capital into the project in the same proportion of their contribution of risk capital, the equity ownership structure may remain the same. Otherwise, the ownership percentage may have to be modified to reflect the new amounts of equity capital contributed by partners of the development entity.

Investors known by the development entity partners are the second best source of equity capital. The primary advantage of dealing with known investors is that these investors can be added as limited investors to the existing development entity legal structure. Another option is to organize the known investors into a private offering syndication (refer to Chapter III, Section VII.B). The cost of preparing such a syndication could be substantially lower than a public offering syndication. Of course, the development entity would still have to prepare the syndication in accordance with all the rules and regulations of the Securities Exchange Commission and state laws.

It may be necessary to use a syndicator to identify equity capital investors. If this is the case, hire a syndicator with a good reputation and track record in securing equity capital for your type of project. The primary disadvantage is that good syndicators are expensive and require substantial equity ownership in the project.

The permanent lender is also a source of equity capital. Here again the greater the equity capital requirements, the less equity ownership will be available to the development. Additionally, permanent lenders may also require a substantial change in the management of the project.

It is the responsibility of the developer, in coordination with the development entity partners to negotiate the best deal possible. Above all, the developer must avoid giving the impression that the development entity's position is a desperate one despite the reality of the situation. If new equity capital investors perceive weakness or a sense of desperation on the part of the development entity, the development entity may be forced to give up more equity ownership than need be.

The best way to ensure a strong negotiating position when

seeking equity capital is to:

- Prepare a complete and comprehensive financial package of the project;
- Identify several alternative sources of equity capital;
- Seek out independent professional advice on what are acceptable and reasonable terms; and
- Negotiate with time on your side.

Following these recommendations will greatly enhance the ability of your development entity to negotiate workable terms in acquiring the needed equity capital.

e. Identification and Commitment of Debt Financing (Financing Phase)

Perhaps the most difficult part of implementing a transit-related real estate development project, is to obtain the necessary financing from lenders. In most types of income-producing projects this is usually done in two stages. A first stage calls for your development entity to obtain a <u>permanent loan</u> commitment from a lender. A second stage requires the commitment of a <u>construction loan</u> to finance the construction of the project. Once the project is built, the permanent lender "takes-out" the construction lender.

There is a very important distinction between the two types of loans. The construction lender (usually a bank) is in the business of short-term loans and therefore must be guaranteed that the loan will be "taken out" by a reliable permanent lender at the completion of construction*. The development entity must work with both types of lenders to ensure that both lenders are satisfied with the financial agreements.

Your development entity would be well advised to seek professional assistance from a reputable mortgage banker in arranging this financing and any contingency financing (i.e. stand-by loans, gap loans, etc.) which may be required by lenders as insurance against construction delays or problems which may arise in the Operation Phase.

i. Permanent Loan Commitment

Permanent loan commitments are difficult to obtain due

---

*In some situations, if the developer has an excellent track record and the development entity has the necessary equity capital, the construction lender can provide a short-term "mini-permanent loan" ranging from three to seven years.

to their long-term structure.* Once a permanent loan is obtained it becomes relatively easy to attract construction financing since construction loans usually have a relatively short loan period. Construction loans of 1-3 years with interest rates pegged at 1-2 points above the prime rate are common.

In preparing a loan package for consideration by a permanent lender, several requirements have to be met by your development entity. If the products of the Final Design Phase are complete, the staff responsible for the Financing Phase should have no problem in meeting the informational requirements of the lender. Although these requirements may vary from lender to lender, at a minimum your permanent loan package should include the following items:

- Evidence of development rights;
- Architectural plans;
- Site analysis;
- Map and narrative description of site;
- Narrative description of project including overall concept, market orientation and type of construction;
- Market analysis;
- Evidence of permissible zoning;
- Narrative material on proposed members of development entity including capability of key members;
- Demonstration of developer's capability;
- Financial position of developer;

*A word of warning is in order regarding the acquisition of permanent financing. We are now in a time of fundamental change in the real estate industry. The persistence of astronomical U.S. national deficits and the uncertainty of rekindling of high inflation has had a profound impact in the way real estate development projects are financed in the United States. As a result, the days of a fixed interest rate, thirty year mortgage are gone. Permanent lenders often require a combination of adjustable rate mortgages (ARMs), share in the cash flow, share in the equity proceeds upon sale, etc. Again, your development entity is encouraged to seek professional advice on how best to structure financial arrangements with permanent lenders.

- Detailed pro forma statements indicating financial feasibility;
- Explanation of loan request accompanied by line item budget;
- Management plan for development project; and
- Marketing plan.

Should the permanent lender approve the loan and once the terms of the loan have been agreed upon, the lender will issue what is generally known as a "take-out commitment". This represents nothing more than a commitment to be the permanent lender to your development entity. In other words, since the project has not been developed the development entity must find a construction lender to finance the construction. However, construction lenders are usually unwilling to make a loan unless they are assured that your development entity has found a permanent mortgage lender who will provide financing to pay off the construction loan when the project is completed. The take-out commitment by the permanent lender provides such assurances.

Since permanent lenders finance projects after construction is completed it is common to impose contingencies on a development entity. Such contingencies are imposed by the permanent lender to assure that the borrower carries out specific responsibilities during the development period. Common contingencies which are imposed prior to a loan commitment include:

- Allowed time for obtaining construction financing;
- Completion date for construction of project;
- Minimum rent-up requirements for permanent financing to become effective;
- Provision for gap financing should rent- up requirement not be met;
- Expiration date for loan commitment;
- Provisions for design changes and approvals.

Contingencies imposed on a loan by a permanent lender need to be fully understood and taken seriously by your development entity. Should established contingencies not be met, the permanent commitment can expire thereby releasing the permanent lender from the responsibility of making the loan. It is important, therefore, that

contingencies in permanent financing be negotiated fully and to the mutual satisfaction of everyone involved.

ii. Construction Loan Closing

As mentioned earlier most construction loans are made once assurances of permanent financing are obtained by a development entity. Further, most construction loans are secured by a mortgage for future advances. Essentially this means that the construction lender has a first lien on the land and all subsequent improvements as funds are disbursed for materials and labor used in the construction of the project.

Construction financing poses special risks to a development entity, in particular, one with little development experience. For example, construction may be slowed down as a result of inclement weather or labor strife. If a slowdown occurs, interest charges, overhead, and real estate taxes can accumulate. This may require that your development entity invest additional equity funds or that the bank increase the loan over the initial amount of the construction loan commitment. Another area of risk lies in the possibility of poor construction management as a result of a firm's inexperience in a particular field of construction. These conditions can lead to cost overruns and delays which can threaten the financial viability of the project.

A further consideration in negotiating a construction loan relates to the take-out commitment of the permanent lender. You may recall that most take-out commitments usually have contingencies attached.

Due to the various risks associated with the construction of a project it is common practice for the construction lender to review your financial and marketing plans with great detail. In general, the construction lender will review the financial and marketing plans of your development entity to determine how much should be loaned based on the economic value of the project. Normally, the construction loan will be made for the hard project costs. The construction lender will also perform a detailed ratio analysis of projected operating statements to determine if the assumptions made conform with local economic conditions. After this detailed analysis is completed the construction lender will make a final determination as to whether the project should be financed.

Once you have received a commitment from a construction lender the closing of the loan is the next

most critical step. Up to the point when the construction loan is closed, you and your development entity are spending limited risk capital to get the project to the closing table. At closing the lender advances funds that reimburse you for most of your out-of-pocket expenses and agrees to continue to lend funds to cover the cost of constructing the project. After closing you have the benefit of using someone else's money and the risk is shared.

What conditions must be present for a successful closing of a construction loan? Although these vary from lender to lender, in most cases, your development entity must provide all or most of the following:

- A firm commitment for permanent financing;
- A building permit;
- An executed construction contract for an amount not to exceed loan commitment;
- Construction contract drawings and any specifications executed by the developer, the architect, the lender or insurer, the builder, and the bonding company;
- A valid executed "development rights" agreement with the local transit agency;
- Evidence of clear title and insurance;
- An executed agreement between the owner and architect;
- Evidence of legality of mortgagor entity;
- Evidence of ability to fund cash equity requirements and working capital needs;
- Performance and payment bonds for the general contractor;
- Evidence of builder's risk and hazard insurance;
- A survey of the property and a legal description acceptable to the lender;
- Various legal opinions and certifications that the method of financing is legal and complies with state and federal laws; and
- An approved management plan, management agreement, and marketing plan.

In sum, satisfying the above conditions provides evidence to the construction lender that the project can proceed. Few loans are closed because all of the details have been worked out. Rather, most loans are closed because the parties involved have established a mutually acceptable closing date and commitment to work out any problems which may exist. Once the loan is closed, all parties are obligated to conform to the requirements established, and construction can begin.

Illustration IV.H suggests an ideal composition of the development team during the Financing Phase.

Illustration IV.H

DEVELOPMENT TEAM IN FINANCING PHASE

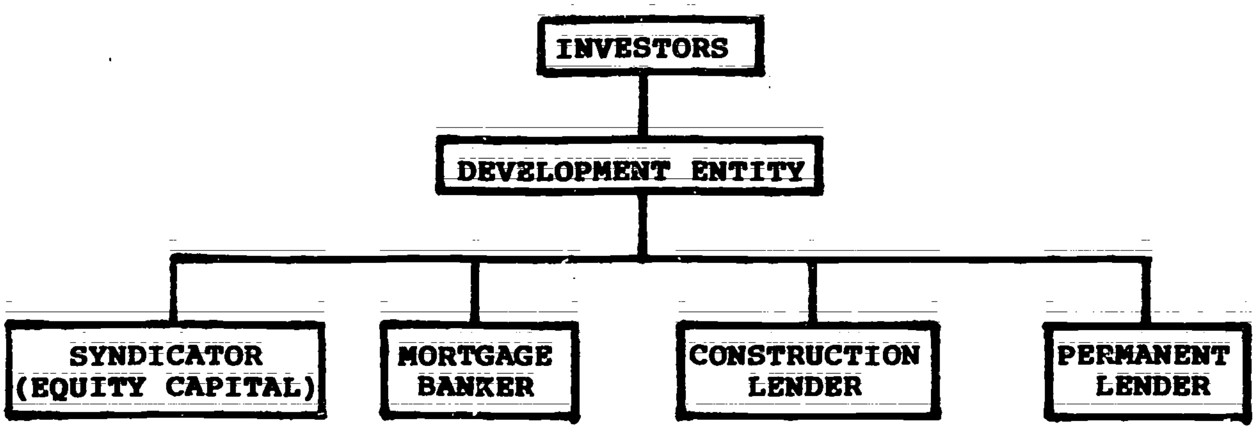
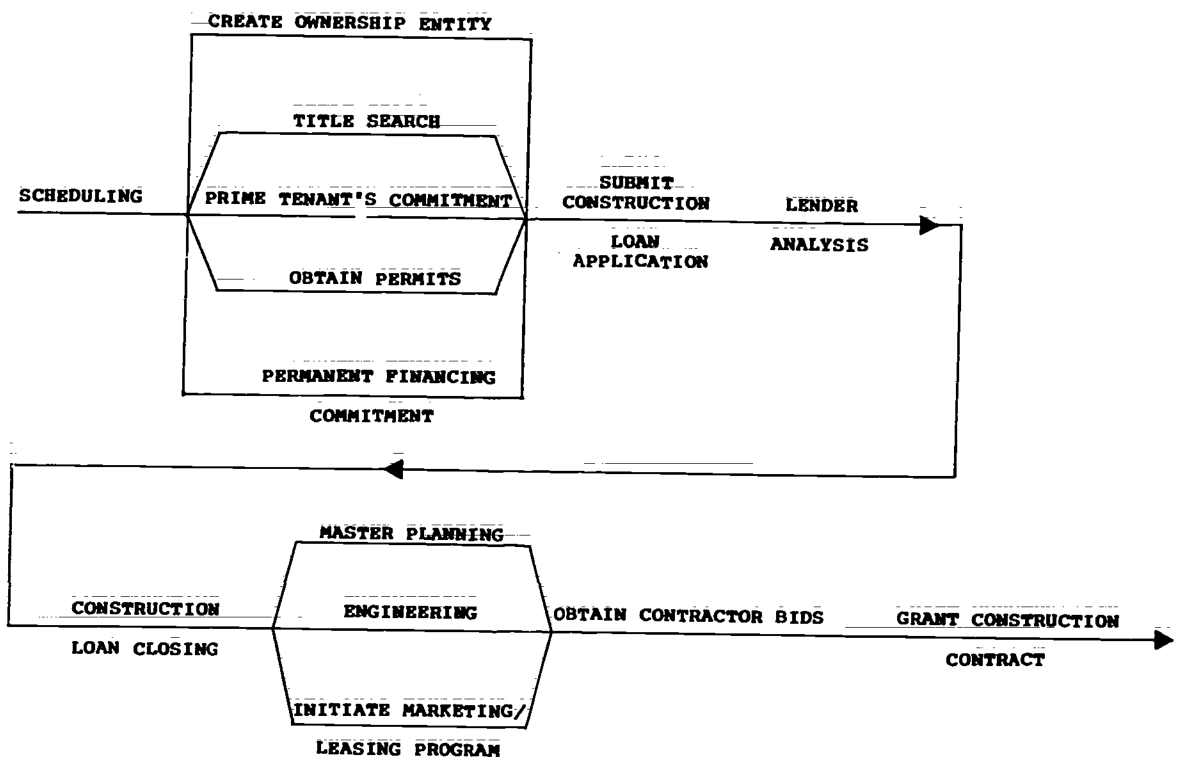


Illustration IV.I describes the major activities undertaken during the Final Design and Financing Phase. As may be seen, these phases are interdependent and parallel.

Illustration IV.I

FINAL DESIGN & FINANCING PHASES



D. Construction Phase

Up to this point of the Development Process, your development entity has been using their "risk capital" to move the project along. You now have the construction lender's money to construct your project. Depending on the arrangements negotiated with your construction lender and your new equity partners (i.e. assuming your development entity had to find

additional equity capital), the new equity capital may or may not be immediately available. But it will be needed to augment the construction lender's loan to complete the project. It is important to keep in mind that the willingness of lenders and equity investors to commit their financial resources was a direct result of:

- Your development entity's demonstrated ability to construct the project; and,
- Their perception that the project would produce a given rate of return on their investment.

Your development entity now carries an awesome responsibility to bring in the project on schedule and within the budget. During the Construction Phase, there is no substitute for detailed scheduling, competent contractors and professional management. It is here where your planning and attention to detail will pay off.

1. Role of the Local Transit Agency

Unless there is a co-construction requirement, the role of the local transit agency is supervisory. This monitoring role must not be taken lightly. The transit agency does have the power to stop construction if the planning and design requirements are violated. Furthermore, the transit agency will demand periodic reviews of each stage of the construction to include reviews of DBE affirmative action plans and other administrative requirements.

DBE development entities are well advised to maintain close and ongoing contact with the transit agency during the Construction Phase. Any modifications to planning and design requirements should be thoroughly reviewed with the appropriate transit agency staff. All approved modifications must be in writing.

2. Role of the Development Entity

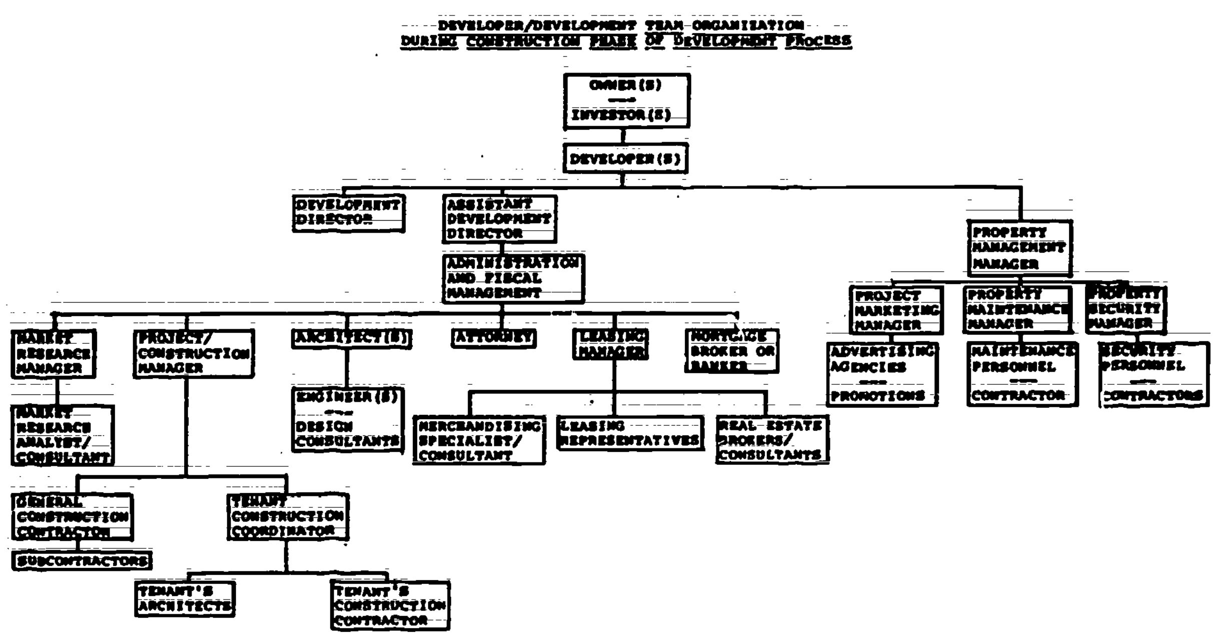
With the construction loan closing behind you, your development entity is now ready to start construction. The Construction Phase brings together a variety of activities which must be coordinated and managed simultaneously. The building must be constructed, marketing of the project must be accelerated, tenant's specifications must be met, etc. Keeping the Construction Phase on schedule and within budget is a critical factor to the success of the project. The following functions must be accomplished during the Construction Phase:

The following functions must be accomplished during the Construction Phase:

- Fully staff the project management team;
- Initiate staffing and contracting for services for on-going property management;
- Start site improvements;
- Fully staff the construction management team;
- Refine marketing research data for use in advertising and promotions;
- Continue architectural (engineering) review for change orders and design modifications;
- Initiate full scale leasing activities;
- Lender approval of progress payments;
- Continuity of overall construction, development and operations;
- Maintain project cash flow management;
- Bid and award all maintenance and security contracts;
- Preparation and initiation of pre-opening and grand opening advertising and promotions;
- Lender approval of completed construction and executed leases (i.e. occupancy permit and occupancy level); and,
- Take out construction loan.

In order to accomplish these functions and other tasks, the development entity must utilize the expertise of various professionals as shown in Illustration IV.J.

Illustration IV.J



Successful completion of the Construction Phase is marked by the permanent lender "taking out" the construction lender from the project. In order for the permanent lender to accept the loan, two critical outputs must be achieved in the Construction Phase: (1) an occupancy permit must be obtained for the project; and (2) the development entity must achieve the prescribed tenant commitments for the project.

The occupancy permit for the project results directly from constructing the project in accordance with the construction specifications set forth by the local transit agency and other related public agencies. Without the appropriate occupancy permit(s), the construction lender will refuse to approve the completion of the project, and therefore the permanent lender will also refuse to take out the construction loan. For this reason, it is absolutely imperative that the development entity focus its attention on complying with these construction specification requirements. Remember, the construction loan is usually at an interest rate higher than the permanent loan. As a consequence, as the project nears completion, every effort must be made to minimize and avoid delays in securing the occupancy permit(s).

Equally important, the permanent lender will demand that the project be financially sound and provide a reasonable expectation of profits on the funds committed to the project. One practice used with great frequency is to commit permanent financing to a project based on its ability to reach a predetermined occupancy level (i.e. signed tenant commitments, such as 60%*. This is referred to as a "floor loan" and might be for 60% of the amount of the fully funded loan called the ceiling loan.

Although the permanent lender may be willing to make a permanent loan equal to the amount of the construction loan, it will do so only if the development entity has arranged for an interim loan that makes up the difference between the floor and ceiling loans. This gap, or stopgap, loan is arranged at the time the construction loan is arranged. Thus your development entity would arrange for a permanent loan, then the construction loan, and next the gap financing, with all these loans probably being finalized at the same time. Some gap lenders will record the gap loan when the construction loan is closed in order

*The predetermined occupancy level established by the permanent lender is usually tied to a minimum Net Operating Income (NOI) necessary to make the debt service payments. Therefore, it must be a top priority of the development entity to identify and secure leasing commitments equal to or exceeding the floor loan percentage requirements prior to completion of construction.

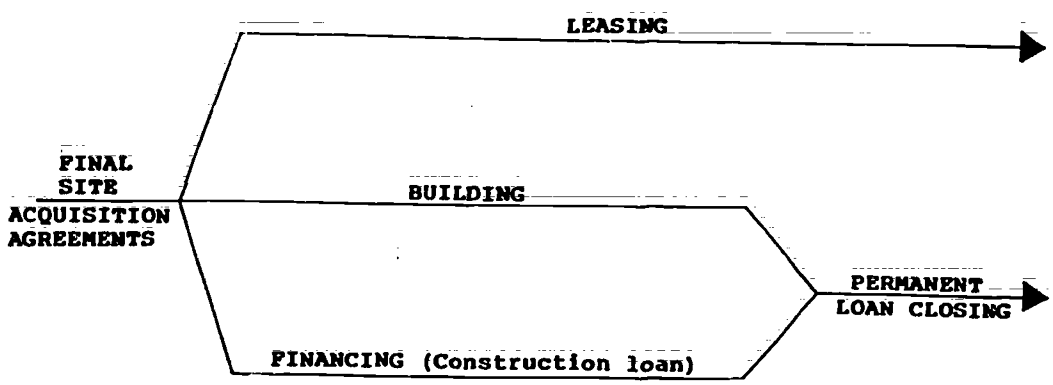
to prevent any intervening liens later endangering their investment.

If the occupancy schedule falls behind schedule, this gap loan will have to be used. Once the development entity gets into this type of difficulty, the project is jeopardized even further because the development entity has two mortgage payments - one, the lower interest rate permanent loan on the floor loan and the other at a considerably higher interest rate on the gap between the floor and ceiling loan. This adds to the aggravation of an already weak cash flow situation. Avoiding this situation must be a paramount consideration of the development entity.

Illustration IV.K portrays the concurrent tasks which must be accomplished during the Construction Phase.

Illustration IV.K

CONSTRUCTION PHASE



E. Operation Phase

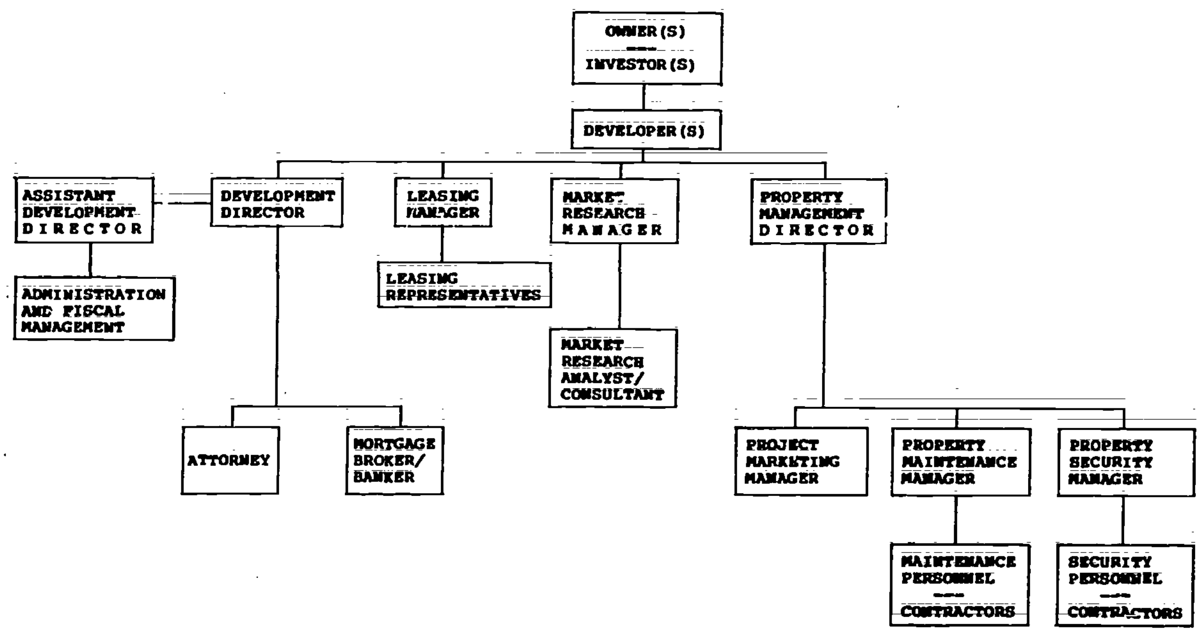
Upon finalizing the permanent loan arrangements, the development entity must now make the transition into the initial Operation Phase*. Several functions and tasks must be performed. Some of the more important are the following:

- Close out all development process accounting, accounts payable and other documents;
- Complete all leasing;
- Complete construction punch list and final acceptance of construction work by tenants;
- Finalize project management team and operations; and
- Begin full scale property management.

Unless there are unique co-operation arrangements of the project with the local transit agency, Illustration IV.L provides typical development team requirements for the Operation Phase.

Illustration IV.L

DEVELOPER/DEVELOPMENT TEAM ORGANIZATION DURING INITIAL OPERATIONAL PHASE



* At the beginning of the Operation Phase, the project is turned over to either a professional management firm under contract to the development entity or to the property management section of the development entity's own organization.

This concludes our discussion on how a real estate development project is put together. As was shown, each phase of the Real estate Development Process presents discrete investment decisions and requires that a pre-described set of tasks be accomplished. All real estate projects must respond to the investment decisions and must accomplish the tasks discussed in order to successfully bring a project from concept to income producing operation.

II. HOW TO UNDERTAKE A PRELIMINARY ECONOMIC FEASIBILITY ANALYSIS

In the first portion of this Chapter, the real estate development process phases were used to explain how a joint development project is put together. This section is designed to assist DBEs in undertaking a systematic "Preliminary Economic Feasibility Analysis" of a specific joint development project opportunity.

Next to choosing your development entity, the "Preliminary Economic Feasibility Analysis" of the project is the most important factor in determining your decision to pursue equity ownership in a joint development project. As emphasized through this manual, a real estate development venture may ultimately produce substantial financial rewards. But in order to get to a point where a project can attract lenders and additional limited equity partners, your development entity must spend a lot of money. Since there is no real project in the ground prior to beginning construction, your entire investment is in a high-risk situation. Thus, it is extremely important that your development entity know from the outset whether a potential project is likely to make economic sense.

A decision to commit financial resources to prepare a development proposal in response to a joint development solicitation <u>should not be done</u> without first undertaking this preliminary analysis.

This preliminary analysis is essential for two reasons. First, it establishes the <u>basic assumptions</u> for estimating financial benefits and risk. If the basic assumptions fail to produce economic projections which can be supported by the local marketplace, the project is likely to be unsuccessful in attracting financing. Furthermore, this preliminary analysis answers the following basic questions:

- What is the amount of "risk capital" required to bring the project to a point where outside financing (i.e. limited partners and lenders) can be obtained?
- How much money can the development entity borrow from a commercial lender based on the economic value of the project?

- Based on the estimated financial benefits of the project, what sources of equity capital will be committed to the project?

- Are the project development costs reasonable and acceptable to the sources of debt and equity financing?

- Will the project need financial incentives from the local transit agency or other public agencies to meet minimal financial viability standards?

Second, this initial analysis can be done relatively quickly and cheaply (under $15,000). Remember, it's your "risk capital" which your development entity must commit along each phase of the Real Estate Development Process prior to obtaining the construction loan. If your "idea" does not make economic sense, you and your development entity are far better off finding out earlier rather than later.

Illustration IV.M provides a step by step display of the preliminary economic feasibility analysis leading a go/no-go decision to pursue the "development rights" for the joint development site. Before undertaking the preliminary analysis, it is strongly recommended that a legal structure among the development entity partners be formed.* At minimum, partners of the development entity should have a written agreement delineating financial contributions, in-kind contributions (i.e. professional services, etc.), responsibilities, and limitations of responsibility. In regard to this matter, it is recommended that an <u>independent</u> attorney experienced in real estate transactions and tax law be chosen by the development entity for consultation.

The remainder of this Chapter will address the specifics of each step of the analysis.

---

*Although the final equity ownership of the development entity participants and additional equity investors is unknown, it is common to create a legal entity for the project which allows the development entity participants to deduct their "risk capital" from their personal tax liability income.

Illustration IV.M*

SUMMARY OF PRELIMINARY ECONOMIC FEASIBILITY ANALYSIS ON JOINT DEVELOPMENT OPPORTUNITIES

ACTIVITY	PURPOSE	RESULT
STEP 1. Review Local Transit Agency joint development offering (i.e.prospectus).	Delineate all financial, design, and development policy requirements and restrictions.	Real Estate Development Idea
STEP 2. Formulate Building Program	Based on all known parameters, translate development entity's development concept into a hypothetical Building Program	Hypothetical Building Program
STEP 3. Conduct a market study for Building Program	Determine whether a market exists for hypothetical Building Program. Based on findings, modify assumptions, redefine design, etc.	Refined Building Program
STEP 4. Determine future operating cost of Building Program	Prepare five year budget for Building Program, line item by line item.	Net Operating Income (NOI)
STEP 5. Calculate the economic value of the Building Program	Based on current mortgage market rates and proposed equity owner's return on investment, calculate capitalization rate. Knowing Net Operating Income and the capitalization rate, calculate the economic value.	Economic Value of Building Program
STEP 6. Estimate the total sources of cash for Buidling Program	Based on economic value, and projected financial benefits of Building Program, calculate the potential mortgage amount and estimate the availability of equity capital.	Total Potential Sources of Cash
STEP 7. Determine the total project development cost	Prepare a detailed breakdown of all project development cost.	Hypothetical Financial Analysis of Building Program
STEP 8. Make a go/no-go investment decision to pursue the proposed joint development opportunity	Based on the financial analysis, determine whether the sources of funds are equal to or greater than the cost to develop the project.	Go/No-Go Investment Decision

* This chart was designed and developed for this manual. The idea for this approach came from Mr. Joseph T. Howell's book entitled <u>Real Estate Development Syndication</u> (refer to bibliography).

A. Initiate a Detailed Review of the Joint Development Prospectus

The local transit agency's prospectus will set forth the parameters of the project (i.e. physical characteristics, ingress and egress, zoning, recommended use, design considerations, financial requirements, etc.). Your development entity must carefully review this prospectus. Based on this review, your development entity should be able to begin to formulate some alternative development programs which meet the transit agency's requirements. Select the real estate development idea which, based on your development entity's knowledge of the local market, best suits the parameters of the site and public sector criteria.

B. Prepare a Building Program

Once your development entity has formulated a potentially feasible idea, begin to formulate a building program (i.e. size, type of building, public space required for transit, amenities, etc.). This building program should be prepared by your developer in cooperation with your architect.* Initially, your building program can consist of typical space requirements for the type of building your development entity desires. Having determined what type of building you believe is marketable in the area, your next task is to obtain detailed information on similar projects throughout your local market and other parts of the country.**

C. Conduct an Initial Market Study

Depending on the professional background of your development entity, your development entity may desire to conduct their own initial market study or seek the advice of a professional market research consultant who knows the area. The latter is preferred for several reasons. First, an independent party can be more objective in recommending marketable components for the building

---

*There are differing opinions as to who should prepare the building program. In most cases the developer takes the lead in determining what should be built on the site. This should not preclude the active participation of your architect or other knowledgeable members of your development team.

**It is in the long-term best interest of each partner of the development entity to take an active role in analyzing other similar projects. As mentioned previously and listed in Appendix One (Sources of Commercial Real Estate Marketing Data & Statistics), there are several sources for obtaining guidelines for various mixed uses in commercial projects. These guidelines should be studied and used to compare your proposed building program.

program. Second, good market research consultants maintain extensive historical data and information on current trends of the local market. This information can be most useful in formulating realistic assumptions upon which to base financial projections. Third, attempt to identify market research consultants who have established good reputations with local lenders. A well known market research consultant can add credibility to your development team.

Your marketing consultant's task is to obtain detailed information on similar projects which will assist your developer in refining your building program to the marketplace. The following is a general inventory of the type of information your development team (i.e. developer and market research consultant) should obtain on similar projects:

- name and location
- date completed
- number of units and size (for residential)
- leasable square footage (for retail/office)
- number of units and size (for hotel)
- rents per square foot
- amenities
- absorption rate (retail/office)
- room rates (for hotels)
- average occupancy rates (for hotels)
- current vacancies
- estimates (if available) of construction and land costs, and operating expenses
- etc.

In addition to the above stated information, your development entity should visit projects similar to your proposed building. Consider going to other cities if your local competition is unwilling to share their experiences. Speak to the owners or management agents. These visits will provide you with insights into some of the problems to anticipate in your project.

Careful analysis of all the information gathered must be undertaken. This analysis will assist your development team (i.e. developer and marketing research consultant) in formulating a refined development concept which is appropriately responsive to the local market. Included in this refined building program should be the following:

- o type of building (hotel, retail, residential, mixed-use)
- o unit mix
- o special transit agency requirements for public space, design criteria, etc.
- o parking requirements
- o amenities
- o net leaseable space (for retail and commercial offices)
- o estimate of room rates (for hotel)

Now that you have a clear idea of what your building program should be, the income generating potential of your project must now be your next priority. (Note: Throughout this preliminary economic feasibility analysis, it may be premature to have your architect fit your building program to the specific site. If your project is economically feasible, there is time enough to involve your architect.)

D. Estimate Future Operating Cost

Now the income potential of the building program must be estimated. This is a most important consideration. For it is the building program's <u>net operating income</u> (NOI) which equals gross income minus losses for normal vacancies and operating expenses which in large measure determines the amount of cash available from the project to service long-term debt and provide a return on equity investor's money. In order to determine net operating income, the development team (developer and market research specialist) must estimate gross income, vacancies and collection losses and operating expenses.

Projected gross income can be determined by utilizing the market rents currently existing for competitive projects* and projecting forward to the time when your project should be at the mid-point of the first year's operation.

---

* If there is an absence of existing competitive rents in your local market, estimates can be obtained by referring to various publications (see Appendices).

The vacancies and collection losses category can vary from market to market ranging from 3% to 7% of gross potential revenue.

As for estimating operating cost, the best method is to prepare a detailed five year budget, line item by line item. Your developer and marketing research specialist should prepare this detailed cost breakdown. Illustration IV.N is a general format for describing the interrelationships among the various income factors used in calculating net operating income. Also included in Illustration IV.N are the typical items used in determining operating cost or operating expenses.

Illustration IV.N

TYPICAL ITEMS USED IN DETERMINING OPERATING EXPENSES

Gross Potential Income		$ xxx,xxx	
Vacancies and collection losses		x,xxx	
Effective Gross Income			$ xxx,xxx
Operating Expenses:			
• management fee	xxx		
• advertising	xxx		
• legal, accounting, and audit fees	xxx		
• elevator maintenance	xxx		
• fuel	xxx		
• electricity	xxx		
• licenses and permits	xxx		
• telephone	xxx		
• water and sewer	xxx		
• gas	xxx		
• garbage and trash removal	xxx		
• payroll	xxx		
• security	xxx		
• decorating	xxx		
• repairs and maintenance	xxx		
• insurance	xxx		
• grounds expense	xxx		
• reserve for replacements (future capital expenditures)	xxx		
• real estate taxes	xxx		
• personal property taxes	xxx		
• employee payroll taxes	xxx		
• payroll benefits	xxx		
• char or cleaning service (for commercial space)	xxx		
Total Operating Expenses			$ xxx,xxx
Net Operating Income (NOI)			$ xxx,xxx

E. Calculate the Economic Value of Your Building Program

With the net operating income determined from the first stable year's estimated budget, how much can your development entity expect to borrow from a permanent lender? Depending on the type of lending institution and type of transit-related real estate development project, a permanent lender may lend between 70% to 90% of the economic value of the project.

The concept of economic value is one of the most important concepts in real estate investment. Lenders use it to make decisions on how much to lend. Investors use it to determine how much to invest. For these reasons, it is critical that DBEs and their development entity partners thoroughly understand the concept of economic value and how it is calculated.

Basically the "economic value" of a project is the value of the investment today, computed by measuring the future benefits of the investment and converting those benefits to reflect their worth in terms of current monetary value. In other words, an investor will pay an amount equivalent to the economic value of all income produced by a property over its economic life. There are several ways of determining the economic value of a project. The most common method used is to determine an overall rate of return or "capitalization rate" which can be used to convert the estimated future income stream of the project into a net present value or economic value. Once the capitalization rate is determined, the economic value of your building program is found by dividing the estimated net operating income (NOI) by the capitalization rate.

$$\text{Economic Value} = \frac{\text{Net Operating Income}}{\text{Capitalization Rate}}$$

The most commonly accepted method for determining the capitalization rate for newly constructed projects is the "weighted average approach." In this method due consideration is given to the fact that the capitalization rate is a composite rate which must reflect the return on investment of the permanent lender and the return on investment of the equity owners. It is determined as follows:

	WEIGHT		COMPONENT		
LENDER'S PORTION	Percentage Loan to Value Ratio	x	Debt Service Constant*	=	Lender's Weighted Average
+					
EQUITY OWNER'S PORTION	Percentage Equity Portion	x	Owner's Desired Rate of Return	=	Equity Weighted Average
	TOTAL CAPITALIZATION RATE			=	________

Let us look at an example taken from the North Street Joint Development Project case study (Appendix One). The development entity in the North Street project checked with their mortgage banker for the best mortgage terms available. They found a lender who was willing to provide a twelve (12%) percent loan rate amortized over thirty (30) years with a balloon payment** after 10 years. The loan was based on a seventy-five (75%) percent loan-to-value ratio. Additionally, the equity owners desired a ten (10%) percent cash on cash return before taxes. As

*The debt service constant is defined as a number which when multiplied by the original loan amount gives the payments necessary to amortize, or pay off, principal and earned interest on the unamortized loan balance at a given interest rate over a prescribed number of years. Ellwood mortgage tables are readily available from lenders, realtors and real estate investment textbooks for determining debt service constants.

**Balloon Payment - The final installment payment on a note when that payment is greater than the preceding installment payments and pays the note in full.

may be seen, twenty-five (25%) percent of the economic value of the project was in the form of owner's equity capital. With this information in hand, the capitalization rate was calculated as follows:

LENDER'S SHARE	75%(loan to value ratio)	x .124144	=	.093108
OWNER'S SHARE	25%(owner's equity)	x .100000	=	.025000
	TOTAL CAPITALIZATION RATE		=	.118108

Combining this capitalization rate with the projected net operating income (NOI) estimated for the project ($3,022,500), the economic value was calculated as follows:

$$\text{Economic Value} = \frac{\text{NOI}}{\text{Capitalization Rate}}$$

$$= \frac{\$3,022,500}{.118108}$$

$$\text{Economic Value} = \$25,590,984$$

With this example in mind, please note that the economic value is determined by dividing the net operating income (NOI) by the capitalization rate. Consequently, if the capitalization rate goes up, the economic value of the project goes down. Conversely, if the capitalization rate goes down (i.e. lower mortgage rates and lower equity returns on investment), the economic value goes up. For this reason, great care must be taken in formulating a realistic capitalization rate which properly reflects the type of permanent financing available and correctly states reasonable levels of return on equity before taxes.

If the only type of permanent financing available produces economic values below what your development entity believes to be the cost of developing the project, then by definition the building program is not feasible. There is no need to continue exploring the economic feasibility of the project.

F. Estimate the Amount of Cash Available for the Project

With the economic value calculated, your development entity is now ready to estimate the total amount of cash which potentially can be raised for the project. There are usually two primary sources of cash for major real estate development projects: debt capital (i.e. long-term loans from financial institutions), and equity capital (i.e. capital from the original development entity participants and other limited partners).* The total amount of cash raised from these two sources must be, at minimum, equal to all the costs associated with the development of the project. If the project can be built for the amount of cash available from these sources, the project is feasible. If it cannot be developed for this amount, the project is not feasible. Let us now examine how these sources of cash for the project are estimated.

1. Estimate Debt Capital for the Project

One of the unique advantages of real estate investments is the ability to "leverage" your capital (i.e. equity capital) with borrowed funds to enhance the buying and earning capacity of your capital. The amount of loan funds available to leverage your equity capital is determined by the lender based on certain criteria:

- Independent appraisal of the economic value of the project;
- Loan-to-value ratio policy (amount borrowed relative to economic value);
- Acceptance of minimum financial ratio standards for the project; and
- Underwriting policies.

*There are a variety of financing alternatives available beyond the traditional debt/equity formula described here. These include participating mortgages, bullet loans, open ended construction loans, etc. Irrespective of the financing alternative, there is a combination of debt and equity which results in a corresponding sharing of financial benefits. These and other various financing alternatives should be explored by the development entity.

As noted above, financial ratio analysis is one of the criteria used by lenders in determining the ability of the borrower to repay the loan. It is important to note that this analysis will be used by the lender to compare your property with similar properties to judge the accuracy of the project's pro forma financials. It must be emphasized that no one ratio computation made by the lender is sufficient to indicate whether a loan should be made or not. The lender must rely on a series of ratios and evaluate all of them together as part of an overall financial analysis.

The underwriting policies of lenders include several objective and subjective considerations. Whether these considerations are negotiable or not depend on the state of the mortgage market, the financial strength of the development entity and market potential of the project. Thus, the lender's previous experience with the development entity's developer, the type of building program, and the development entity developer's previous record of success with the proposed type of project can influence not only the amount of the mortgage loan the lender will make, but also the terms of the loan as well. Understandably, loans which the lender views as posing greater risks will serve to reduce the amount of loan the lender is willing to make or to impel the lender to refuse the loan entirely.

For the purpose of this preliminary economic feasibility analysis, a good indication of the potential capital available from long-term lending institutions (i.e. permanent lenders) may be obtained from mortgage brokers and mortgage correspondents. They are aware of the policies of mortgage lending institutions, and they know which institutional lenders are actively engaged in making mortgage loans on your type of project, at what interest rate, and on what terms. Assemble the following information from your mortgage banker(s):

- Based on the type of project (hotel/retail/ office/etc.) and type of lenders, obtain the prevailing loan-to-value ratio;
- Obtain realistic long-term mortgage rates and mortgage terms (repayment period, repayment method, etc.); and
- Obtain the current acceptable levels used by potential permanent lenders for selective financial ratios*. Some of these financial ratios could include the following:

*Current acceptable levels for these financial ratios and other ratios may also be obtained from the American Life Insurance Institute, Washington, D.C., Mortgage Bankers Association, Washington, D.C., and other associations representing long-term lenders.

$$\text{Operating Expense Ratio} = \frac{\text{Operating Expenses}}{\text{Effective Gross Income}}$$

$$\text{Break-Even Ratio} = \frac{\text{Operating Expenses + Debt Service}}{\text{Effective Gross Income}}$$

$$\text{Debt Coverage Ratio} = \frac{\text{Net Operating Income}}{\text{Annual Payments of Principal \& Interest}}$$

With this information your development entity and mortgage bank are now in a position to estimate the potential debt capital available for the project.

2. Estimating the Equity Capital Needed for the Project

Now that the development entity has a reasonable idea of the potential loan amount and terms, the equity capital potentially available to the project must be estimated. The amount of equity capital available to the project is a function of several factors:

- Total financial benefits* produced by project;
- Market for these financial benefits; and
- Risks the development entity is willing to take to attract the necessary equity capital.

Let's examine each of these factors influencing the availability of equity capital for the project.

First, the amount of equity capital potentially available is a function of the total financial benefits produced by the project. As discussed in Chapter Three, the financial benefits are measured by the return on investment produced from cash flow, tax shelter benefits and the eventual projected cash to be received from the sale or refinancing of the project. These financial benefits must be balanced by the inherent risk in

*Refer to Case Study One in the Appendix for a detailed examination of how the total financial benefits of a project are determined.

owning a portion of your particular project (i.e. type of commercial property, location, and perceptions of your development entity's ability to construct and manage the project). Additionally, the amount of cash needed and the timing of this investment may be a consideration especially if additional amounts of equity may be required.

Second, the amount of equity capital available is a function of the market for the financial benefits offered by the project. Your development entity may find that high interest rates and other alternative investments (i.e. stocks, bonds, commodities, etc.) make your financial benefits less than competitive. Or, the cost of syndicating your project through a syndicator may be more than your project can afford and still provide competitive financial benefits. These and other factors may make your financial benefits difficult to attract investors. It is therefore absolutely essential that your development entity realistically analyze the financial benefits available and match these financial benefits with a group of known limited equity investors. If a group of known limited investors is unavailable, seek the advice of a well respected equity capital syndicator to determine the marketability of your financial benefits.

Third, the amount of equity capital available is a function of the risk the development entity is willing to take to attract the required equity capital. In order to attract the needed equity capital from known limited investors or through a syndicator, the development entity has to reduce its share of the project's financial benefits and increase its financial risks. For example, the development entity may have to sell 99 percent of the project's financial benefits yet retain unlimited liabilities for obligations of the project. Additionally, the development entity may be required by the limited investors to provide guarantees against construction overruns and initial operating deficits. To the extent the development entity agrees to limit their participation in the financial benefits and agrees to these guarantees, the project may become very attractive to potential investors at the expense of the development entity.

The development entity must carefully analyze the project's total financial benefits, market for these financial benefits, and the risks necessary to attract equity capital. Compromises must be made. But most important, an amount of equity capital realistically available to the project must be determined.

If the project can be built for the amount of money available for debt capital and equity capital, the project is feasible.

G. Determine the Total Project Development Cost

Before a final decision can be made regarding the economic feasibility of a project, the total project development cost must be determined. An important consideration in determining these costs is what type and level of costs will be acceptable to the lender. If there is sufficient economic value in the project, the lender normally will allow any justifiable cost to be included in the project. On the other hand, the level of fees allowable in the project often becomes a point of extensive negotiations.

The basic formula for breaking down project cost is shown below:

SOURCE OF FUNDS
- **Loan proceeds**
- **Capital contribution from limited partners**

USE OF FUNDS
- **All project development costs:**
  - **site acquisition costs**
  - **construction costs**
  - **financing costs**
  - **all other project soft costs**
- **All syndication costs:**
  - **legal fees**
  - **syndication fees**
  - **sales commissions**
- **Developer fees:**
  - **developer fee**
  - **construction guarantee fee**
  - **operating deficit guarantee fee**
  - **development management fee**
  - **reporting fee (as required by transit agency)**

Another way of describing this basic formula from the view point of the development entity is as follows:

TOTAL SOURCES OF FUNDS
- **Loan proceeds**
- **Capital contributions**
  - **Less all project development costs**
  - **Less all syndication costs**
  - **Equals amount of money available to development entity for profit, overhead, and related fees.**

In preparing the preliminary economic feasibility analysis, it is recommended that the development entity's developer (with the advice of appropriate consultants) prepare a "detailed project cost breakdown" of all anticipated costs. Even costs which may be eventually disallowed by the lender should be included. This project budget serves two purposes: First, the project budget will put the development entity on notice as to the amount of "risk capital" needed to prepare the development proposal and carry the project to the point where outside financing can be obtained. Second, the project budget will provide not only a measure of financing needed (debt capital and equity capital), but it can be an effective management tool for controlling cost and evaluating risk to the development entity throughout the development process.

Illustration IV.0 provides a general guide of the project expense items which should be used in estimating the overall project cost. This example was developed for an average $15 million to $25 million commercial project in 1980. The range of costs by item should be updated before using these figures to estimate project cost. Furthermore, it must be remembered that project item cost varies according to the size of the project. Therefore, the main objective of Illustration IV.0 is to show the project expense items commonly included in determining total project cost. Minimal value should be given to the range of cost presented without first updating these 1980 figures.

Any additional costs incurred or anticipated but not included in Illustration IV.0 should be added to the development entity's project budget. For example, there may have been real costs initially incurred in getting the development entity partners together or costs incurred to identify and interest limited equity partners in the project. Someone in the development entity incurred these real costs. Including these and other real costs in the project budget may well avoid hard feelings among partners of the development entity. Additionally, a close accounting of all project costs will ensure that all partners of the development entity clearly understand the short and long-term financial impact of the project.

Illustration IV.O

OVERALL PROJECT DEVELOPMENT COST

PROJECT EXPENSE ITEM	GENERAL RANGE OF COST
(LAND/PROPERTY)	
-PURCHASE PRICE	(15-20% OF PROJECT COST)
-SALE TRANSFER TAXES	(.5-2% OF PURCHASE PRICE)
-PURCHASE SETTLEMENT EXPENSES	(4-6% OF PURCHASE PRICE)
-APPRAISAL	($1,500-$4,000)
(FEASIBILITY STUDY)	
-MARKET ANALYSIS	($ 5,000-$10,000)
-SITE ANALYSIS	($10,000-$15,000)
-PRELIMINARY DESIGN	($12,000-$18,000)
-MAJOR TENANT PROSPECTS	($ 5,000-$10,000)
-PROJECTED CASH FLOW	($ 1,500-$ 2,000)
-FINANCING FEASIBILITY	($ 1,000-$ 2,000)
(CONSTRUCTION/RENOVATION)	
-BUILDING IMPROVEMENTS	($20-$45/SQUARE FOOT)
-SITE IMPROVEMENTS	($ 7-$20/SQUARE FOOT)
-ARCHITECTURE/ENGINEERING	(3-6% OF CONSTRUCTION COST)
-INSURANCE DURING CONSTRUCTION	(1-1.5% OF CONSTRUCTION COST)
-CONSTRUCTION MANAGEMENT	(4-6% OF CONSTRUCTION COST)
-TENANT IMPROVEMENTS	($2-$5/SQUARE FOOT)
(PROJECT MANAGEMENT)	
-ORGANIZATIONAL PERSONNEL	($50,000-$80,000)
-PROFESSIONAL SERVICES	($ 5,000-$25,000)
(MARKETING)	
-REAL ESTATE BROKERS/LEASING	(5-7% OF ALL RENTAL INCOME)
-MODEL UNITS FURNISHING	($1,000-$ 1,500)
-BROCHURES	($5,000-$10,000)
-POSTAGE & MISCELLANEOUS	($2,000-$ 5,000)
-LEASING ADVERTISING	($5,000-$10,000)
(OTHER EXPENSES)	
-REAL ESTATE TAXES	(LOCAL PROPERTY TAX FORMULA)
-LEGAL	($25,000-$40,000)
-FISCAL PLANNING & ACCOUNTING	($ 2,000-$ 3,000)
-PROPERTY MAINTENANCE & EQUIPMENT	($ 3,000-$ 5,000)
-TRASH REMOVAL	(NEGOTIATED)
(FINANCING)	
-CONSTRUCTION LOAN DISCOUNT POINTS	(2-5% OF LOAN AMOUNT)
-CONSTRUCTION LOAN INTEREST	(2-4 INTEREST POINTS OVER THE PRIME LENDING RATE)
-BROKERAGE FEES - CONSTRUCTION LOAN	(2-5% OF LOAN AMOUNT)
-MORTGAGE LOAN DISCOUNT POINTS	(2-5% OF LOAN AMOUNT)
-MORTGAGE LOAN STAND-BY FEE	(1-2% OF LOAN AMOUNT)
-BROKERAGE FEES - MORTGAGE LOAN	(1-2% OF LOAN AMOUNT)
-EQUITY FUNDING COST	(5-10% OF CAPITAL RAISED)
(CONTINGENCIES)	(1-5% OF PROJECT COST)

H. Make a Go/No Go Investment Decision

Based on the results of the preliminary economic feasibility analysis, your development entity is now in a position to begin your final evaluation of the present joint development opportunity. So far, the information gathered has produced the following:

- A refined Building Program responsive to the local market demands of the site;
- The Net Operating Income (NOI) generated by the proposed building program;
- The potential Economic Value of the building program;
- An estimate of the maximum Debt Capital and Equity Capital potentially available for the project; and
- A detailed breakdown of Total Project Cost.

With the above stated information in hand, the development entity must begin to ask some hard questions as a precursor to making an investment decision to pursue this equity ownership opportunity.

QUESTION ONE

Does the proposed "building program" offer a unique advantage over competing proposals? If so, is this competitive edge sufficient to win the development rights to the site?

QUESTION TWO

Does the development entity possess the experience in similar projects and a track record of successfully completing similar projects? Does the development entity's developer have credibility with the transit agency, possible lenders and potential limited equity investors?

QUESTION THREE

Does the development entity have the available "risk capital" to prepare a competitive development proposal? Does the development entity have the financial commitments to carry the project to the point where outside financing can be obtained?

QUESTION FOUR

Is the estimated debt capital and equity capital sufficiently available to cover all proposed total project costs? Are these sources of debt capital and equity capital reliable?

QUESTION FIVE

Does the development entity have a contingency plan to cover cost overruns?

QUESTION SIX

Are all partners of the development entity satisfied with the proposed return on investment and risks associated with the project? If no, are alternative partners with equal background, experience and/or access to financial resources available?

The answers to this set of questions will assist in making your investment decision. If the answers to these questions are all affirmative, the chances for success are excellent and therefore the development entity should seriously consider competing for the project. If all of questions one through four are positive, the development entity still has a good chance to compete for the development rights to the site. If any of the set of questions one through four is negative, the development entity should seriously rethink its chances for success and possibly consider terminating its efforts to compete for the present joint development opportunity.

Irrespective of your development entity's decision to pursue a particular joint development opportunity or not, the preliminary economic feasibility analysis is a valuable and essential analytical tool. Should your development entity decide to respond to the joint development solicitation, your development team now has specific guidelines and direction developed from the preliminary analysis. Should your development entity decide not to pursue the equity opportunity based on the results of the preliminary analysis, your partners may be wiser and better off for their decision.

The importance of the preliminary economic feasibility analysis cannot be overstated. Its proper execution is at the essence of a successful project. Your development entity is encouraged to use this preliminary analysis approach as a prerequisite to preparing a formal development proposal in response to a transit agency joint development site solicitation.

This concludes Chapter Four. For a practical example of how the principles and concepts of this chapter come together please refer to Case Study One, The North Street Joint Development Project in Appendix One.

APPENDIX ONE

CASE STUDY ONE: NORTH STREET JOINT DEVELOPMENT PROJECT

NORTH STREET JOINT DEVELOPMENT PROJECT

OVERVIEW

This case study is based on an actual transit-related real estate development project. The circumstances surrounding the case study have been modified, for instructional purposes, to reflect optimal conditions leading to the preparation and submission of a proposal to acquire the "development rights" to a joint development project. Specifically, this case study demonstrates how a minority/woman entrepreneur was able to maximize her resources and structure a major equity ownership and management role in a joint development project. The case study emphasizes ownership/organizational issues, the financial structure of the deal and the mathematical analysis underlying the financing.

• ENVIRONMENTAL SETTING

The city used as a background for this case study received its first Urban Mass Transportation Administration (UMTA) grant to commence its rapid transit system planning and design in 1967. By the mid 1970s, the transit system (i.e. referred to as METRO) was well under construction. Although the local transit agency had completed almost half of the proposed transit system by 1980, minority and women owned businesses had obtained less than five (5%) percent of the dollar volume of all local business opportunities generated from the development of the transit system.

As a result of pressure from the city council and the minority/women business community, the local transit agency Board of Directors established new joint development policy guidelines which include a strong commitment for minority/women business participation in joint development projects. The following Disadvantaged Business Enterprise (DBE) goals were instituted for all new joint development projects:

o Twelve (12) percent participation by minority investors in equity ownership of development projects;

- Twenty (20) percent DBE participation during the development period in the following categories:
  (1) construction of building (as prime or subcontractor);
  (2) non-construction services;
  (3) professional services;
  (4) building management;
  (5) supplies and services; and

- Ten (10) percent goal for the initial leasing of retail rental space to DBEs which shall continue for five (5) years from the date of full occupancy; and,

- Fifteen (15) percent goal during the entire term of the lease for DBE participation in the management and operation of the building, inclusive of all purchases, supplies, building services, including janitorial services.

Shortly after the release of these DBE joint development goals, the local transit agency announced they were preparing a prospectus (i.e. request for proposal) for the "development rights" to the North Street joint development site. Consequently, the North Street joint development site represented the first test case for the new DBE joint development policies.

- **PROPOSED JOINT DEVELOPMENT SITE**

The proposed joint development site was located at the corner of North Street and Broadway Avenue. The site was originally owned and cleared for development by the local redevelopment agency. Construction on the site was delayed by the redevelopment agency until after the alignment of the METRO lines and transit station sites were determined. As it turned out, the local transit agency's internal studies indicated that this redevelopment agency site would be ideally suited as a transfer point transit station to lines leading to the suburbs.

After years of delay and disagreement between the local redevelopment agency and the local transit agency as to who would be the public agency responsible for the joint development site, the local transit agency was selected (through the "political" process) to be the lead agency. The site was named the North Street Joint Development Project.

Not only was the North Street joint development site a transfer point; the site was strategically located. The site was half way between the older downtown business manufacturing section of the city and the new financial/commercial office business section of the city. Although the immediate neighborhood around the site was in transition between old and new, the market potential of the area was untested.

• THE LOCAL DEVELOPMENT COMMUNITY

The city's major developers were displeased with the way the pre-development activities on the North Street joint development site were progressing. The city's major developers would have preferred the redevelopment agency as the lead agency on the North Street project due to their long term relationship with the agency. Additionally, several of the major developers were ambivalent about including DBE equity partners in their proposals for the upcoming solicitation on the North Street project. They were worried there were not enough competent and bondable DBE contractors to do the work. Furthermore, the major developers claimed they did not know how to identify DBE investors to include as equity partners in their proposals.

The issues raised by the major developers were legitimate concerns, which the local transit agency was unprepared to adequately address prior to the scheduled solicitation for proposals on the North Street site. Under pressure from the major developers, the local transit agency attempted to compile a list of all the city's DBE sub-contractors and a list of all the minority/women professionals (i.e. as potential DBE investors) they could find listed in the metropolitan area's telephone books. Major developers remained unconvinced. (NOTE: On subsequent joint development site solicitations, the local transit agency did address the bonding issue and developed an excellent list of potential DBE investors.)

• THE MINORITY/WOMEN'S BUSINESS COMMUNITY

Despite the local transit agency's commitment to DBE participation in joint development projects, the minority/women business community was uncertain how best to organize itself to pursue equity ownership in the upcoming North Street joint development project. In general, DBE construction sub-contractors were more interested in obtaining work for their firms than in pursuing equity ownership opportunities. As a result, they preferred to wait to see which of the major developers/contractors would call them to participate as subcontractors on the project. On the other hand, several meetings were held among prominent non-construction related DBE investors to discuss the equity opportunity potential of the North Street site.

One of the prime movers behind the effort to get meaningful DBE equity participation in joint development projects was the owner of a very successful commercial leasing and real estate company, Ms. Maria C. Gonzales. After the announcement of the new local transit agency DBE policies on joint development projects, Ms. Gonzales attempted to organize a group of potential DBE investors (outside the real estate industry) to join with her

to submit a development proposal on the North Street project. Although these DBE investors respected Ms. Gonzales as a business person and as a knowledgeable commercial leasing agent, her lack of experience as a developer caused them to reject her initial proposal.

• THE EMERGENCE OF A DBE DEVELOPMENT ENTITY

Ms. Gonzales' experience in trying to convince DBE investors to follow her lead did result in a valuable lesson. Despite her success in commercial leasing and extensive experience in working with the major developers in the city, she realized she lacked the credibility needed to attract equity capital and lenders. She therefore decided to seek out a joint venture partnership with a major developer to complement her resources.

Ms. Gonzales believed her resources offered a distinct advantage to any development team competing for the "development rights" to the North Street joint development project. First, she knew the local commercial leasing market as well as anyone. Second, based on her experience in working the North Street and Broadway Avenue area commercial leasing market, she understood what type and mix of commercial space (i.e. building program) would be most appropriate at the joint development site. Third, she knew several successful entrepreneurs who were still interested in investing in major real estate projects despite the initial rejection of her earlier proposal. Last, her commercial leasing and real estate firm had an excellent reputation among the local banks and major developers. These were valuable resources which she wanted to translate into an equity ownership position on the North Street joint development project.

Ms. Gonzales approached several of the major developers in the city to solicit their interest in a joint venture on the North Street project. She was careful not to share her building program ideas with the developers. Instead, she stressed the benefits of her other resources. None of the major developers was willing to accept her investor group as a major partner. Nevertheless, all of the major developers were willing to consider her investor group as limited partners and some were interested in her services as a commercial leasing agent for the project.

Undaunted by these rejections, Ms. Gonzales reflected on why her resources were not valued by the major developers. She discovered that in her presentation to the developers, she referred to her initial investor group (both DBE and non-DBE investors) as her partners. This left the impression with the developers that her initial group of investors also wanted to be general partners. This was not the situation at all. It was she who wanted to be a general partner in a joint venture with the developer. The initial investor group would be limited partners

(i.e. provide equity capital with no management participation). This was an important clarification the developers needed to know. This was an important discovery for her. Most developers are reluctant to be general partners with an individual who has little or no experience in real estate development. This is usually the case because developers do not have the time nor do they want to accept the liability of educating partners on the job.

In discussing her dilemma with a group of trusted land use attorneys, she was advised to discuss her proposal with a prominent developer, Mr. Benjamin Samson. Mr. Samson had an excellent reputation for developing mixed-use commercial office/retail space in the Northern suburbs outside the city. The attorneys also indicated a desire to participate with her as initial limited partners if this developer was willing to enter into a joint venture with her.

After verifying Mr. Samson's reputation as a well-established commercial developer, Gonzales and Samson met. The meeting resulted in a tentative agreement to initiate a joint venture. The highlights of the joint venture agreement were the following:

- Ms. Gonzales and Mr. Samson would be the general partners of a company created for the project and retain 17.5% ownership respectfully;

- The general partnership would attempt to raise equity capital by selling off 99% of the tax benefits, 99% of the cash flow, and 65% of the net proceeds from the sale of the project or refinancing after 7 years;

- As a way of enticing Samson into the project, Ms. Gonzales agreed to commit $25,000 in cash to pay for all the initial out-of-pocket expenses associated with determining the economic viability of the project. If and only if Mr. Samson was satisfied with the results of this preliminary analysis, would he be obliged to contribute his cash contribution.

- Ms. Gonzales would be responsible for obtaining firm commitments for all additional "risk capital" needed from the time the "development rights" would be obtained until construction financing was secured. Ms. Gonzales agreed to take no commission for raising these monies. These monies would be committed to the project upon notification the joint venture won the "development rights" to the North Street site;

- If the preliminary analysis proved to be economically viable and if Ms. Gonzales obtained firm financial commitments for all the "risk capital" needed (as determined by the preliminary analysis) Mr. Samson would commit $200,000 cash for all out-of-pocket expenses associated with preparing the development proposal to the transit agency;

- Mr. Samson would be responsible for securing additional equity and debt capital for the project;

- Mr. Samson would be the developer and provide a guarantee against construction cost overruns as part of his developer fee (4% of project cost plus $200,000 bonus if project was brought in on schedule). If the project was completed behind schedule, the developer fee would be reduced to 2 1/2 % and no bonus.

- Ms. Gonzales' commercial leasing and real estate firm would be the exclusive leasing agent for the project;

- Operational management of the project would be done by the joint venture company;

- All operating deficits would be guaranteed by both Gonzales and Samson;

- Both partners agreed to include DBE consultants and DBE sub-contractors in every phase of the development process and operation of the project in excess of the minimum DBE participation goals established by the local transit agency if possible.

With this joint venture agreement in hand, Ms. Gonzales had the beginnings of a formidable development team. She now had the credibility she needed with equity investors and lenders. She had a development team partner capable of competing with the best of the city's major developers.

Her next task was to obtain commitments from DBE consultants and DBE contractors to join her development team. With the assistance of her partner, a tentative agreement was reached with a well respected but little known DBE architect to join the development team. The two largest construction contractors were contacted to solicit their interest in participating on the development team. As a condition of their participation, they were requested to joint venture with smaller DBE contractors who had good reputations but not the experience, equipment, staff and bonding to undertake the construction of the project by themselves. One of the large construction contractors agreed to participate on the development team in joint venture with the

largest DBE contractor in the city. Her development team now not only had credibility, but was setting the standard for DBE participation in joint development projects.

Prior to signing the joint venture agreement with Mr. Samson, the agreement was reviewed by her land use attorneys. They advised her to sign the agreement and renewed their commitment to invest as part of the initial limited partner group. The joint venture agreement and the commitment for equity capital from the attorneys were well received by Ms. Gonzales' potential DBE investors. A verbal agreement was obtained from the DBE investors to consider her need for equity capital once the financial requirements were known.

• PRE-SOLICITATION ANALYSIS AND TACTICS

While identifying and selecting a development team, Ms. Gonzales' staff began to gather as much information on the North Street joint development site as possible. The staff research indicated the following:

- the local transit agency favored a mixed-use commercial office/retail development plan for the site;
- the local transit agency would require the developer for the site to set aside a minimum of 25,000 square feet for public space within the proposed building;
- the local transit agency was considering a minimum land-lease guarantee payment of $12 per square foot per year for the development rights to the site; and,
- the local transit agency was planning to allow 90 days for developers to submit their development proposals for the North Street project.

Based on her knowledge of the local market, the size of the site and zoning height limitations on the property, Ms. Gonzales was concerned that the public space requirements and minimum land-lease rent requirements would cause a substantial negative cash flow in the initial years of operation. Only the largest of the city's major developers could risk such a possibility.

Ms. Gonzales organized a group of prominent DBEs (part of her limited partner group) and interested major developers to meet with the local transit agency to verify her information about these issues. Her information was correct. After several hours of discussion, the local transit agency agreed to re-evaluate the public space and land-lease requirements before finalizing the solicitation.

The local transit agency was less receptive to extending the solicitation period of 90 days on this project. Extending the solicitation period would require transit system design delays in other parts of the system. In response to the local transit agency's apparent reluctance to reconsider this issue, Gonzales and the developers pointed out that a comprehensive market analysis alone would take 90 days. The architectural design would take another two months. Finalizing the development proposal would add another two months at minimum. Despite these arguments for additional time in which to prepare a competitive proposal, the local transit agency staff were non-committal on this issue.

• DETAILED REVIEW OF THE LOCAL TRANSIT AGENCY PROSPECTUS

When the prospectus was published by the local transit agency, Ms. Gonzales, Mr. Samson, the architect and the project attorney reviewed the document. Among the salient points of the North Street joint development prospectus were the following:

- the proposed "development rights" were for 24,500 square feet of cleared land at the corner of North Street and Broadway Avenue;
- interested bidders would have one hundred and eighty (180) days in which to submit a proposal in compliance with the specific requirements set forth in the prospectus;
- land-lease period on the property was to be fifty (50) years with an option to renew based on reappraisals for an additional period up to forty-nine (49) years;
- land-lease proposal must contain an offer of a minimum of eight (8) dollars per square foot or a specific percentage of effective gross income;
- proposals must be accomplished by a bid bond (certified check or bank letter of credit acceptable to METRO in the amount of $50,000 to guarantee that such proposal will not be withdrawn for a period of 60 days during METRO's review of said proposal; said bid bond returned to all unsuccessful parties within ten (10) days after METRO's review period);
- a cash sum of $100,000 shall be paid to METRO upon execution of the contemplated lease (the lessee's original proposal guarantee deposit may be applied);
- proposal must include a Statement of Qualifications containing: the developer's corporate charter, partnership agreement or other organizational documents,

qualifications of developer and each member of the development team and a record of past performance on similar projects demonstrating timely and successful completion;

- complete statement on the financial ability of the prospective party to accomplish the planned development;
- lessee will be required to develop the site in conformity with development plans approved by METRO (i.e. twelve story limitation, highest commercial mixed use, station area planning with a minimum of 10,000 square feet as public area within the project, etc.)
- proposal must include a graphic description of the proposed development consisting of preliminary plans and outline specifications prepared by a qualified architect and must include a site plan, schematic floor plans, and elevations and cross sections;
- proposal must include financial pro forma analysis of gross and effective gross income expectancy after initial full occupancy of the contemplated improvements;
- proposal must contain Disadvantaged Business Enterprise (DBE) plan to include equity participation, contracts for professional and technical services, construction contracting, purchasing of materials and supplies, and building leasing and management in accordance with minimum DBE participation goals.

Upon review of the prospectus, Ms. Gonzales and her development team were pleased to discover that the local transit agency had lowered the minimum guaranteed rent requirement and the public space requirements. Despite the local transit agency's initial reluctance, the development team was pleased by the 180 day period provided for preparing a response to the solicitation. Attendance by the development team at the bidders conference held by the local transit agency also proved extremely helpful in clarifying the prospectus and financial objectives of the transit agency.

The joint venture general partnership agreement was now in effect. Ms. Gonzales opened an account for the general partnership with her $25,000 cash. Mr. Samson also made arrangements to fulfill his financial commitments to the project if the preliminary analysis proved positive.

FORMULATION OF A BUILDING PROGRAM

Based on Ms. Gonzales' experience in assisting clients to lease commercial space in the North Street Transit Station area,

she believed she knew the local market as well if not better than anyone else. Her general partner, Mr. Samson, was less familiar with the needs of the local market but had extensive experience in formulating successful building programs. The project architect was an excellent designer with extensive background in construction costing. Together, they began to formulate a building program.

Their development concept attempted to take advantage of three market factors. First, the area along Broadway Avenue needed more Class A office space to accommodate the growing office requirements from the nearby light industry manufacturers. Additionally, many office automation vendors and service providers desired offices located somewhere between their manufacturing and business clients in the financial center of the city. This site was ideally located for both these commercial office demands. Second, the area lacked good, attractive restaurants for executive lunches and dinners and fast food restaurants for the local daytime work force. Third, upscale retail stores were unavailable within the immediate area for the day time work force and occasional commuters. A building program which combined these factors could only be enhanced by the fact that the North Street Transit Station was a transfer point for commuters working in both the manufacturing and financial service sectors of the city.

Consequently, a building program was created which included office, retail, restaurant, parking and public space. Now the question was: "Is it economically feasible?"

• THE MARKET STUDY FOR THE BUILDING PROGRAM

Ms. Gonzales and Mr. Samson were well aware of the importance of a good market study. Not only would the market study verify their hunches of what should be built, the market study results would allow them to refine their building program.

The general partners agreed to hire a well-established and reputable certified public accounting firm which also maintained a division which specialized in commercial real estate market research. A small fee ($3,000) was negotiated for the initial market study based on an agreement to use this same firm to undertake the more formal market study and preparation of financial pro formas for the project.

The market study verified Ms. Gonzales' assumptions about the market. Based on this market analysis, Mr. Samson and the architect finalized a twelve-story, 348,000 S.F. (gross) building complex consisting of the following net space allocations:

- 200,000 S.F. (office)
- 30,000 S.F. (retail)
- 70,000 S.F. (parking)
- 10,000 S.F. (public space)

• ESTIMATING THE PROJECT'S FUTURE OPERATING COST

One major advantage of hiring a well-established commercial real estate market research firm was their access to historical data and comparative data on commercial property leasing income and operating expenses. Combining the market research firm's income/expense data with the general partners' information on projected income/expenses proved most helpful. As a result, the general partners were able to develop the following operating income and cost estimates:

INCOME:		
200,000 S.F. (office) @ $19/S.F.	=	$3,800,000
30,000 S.F. (retail) @ $21/S.F.	=	630,000
65,000 S.F. (parking) @ $4/S.F.	=	260,000
10,000 S.F. (public space) @ $0	=	0
POTENTIAL GROSS INCOME		$4,690,000
VACANCY (5%)		234,500
EFFECTIVE GROSS INCOME (E.G.I.)		$4,455,500
EXPENSES:		
200,000 S.F. @ $5.75/S.F.		
30,000 S.F. @ $2.75/S.F.		
Land Lease Payment to Transit Agency @ 4.5% of EGI*		1,433,000
NET OPERATING INCOME (NOI)		$3,022,500

---

* With a land lease payment of 4.5% of EGI, the transit agency will get precisely $8/square foot on the site. As the project EGI increases, the land lease revenues will increase.

From the operating cost calculations, the general partners were able to obtain the Net Operating Income (NOI). Now to calculate the capitalization rate in order to convert this income stream into an economic value.

To determine the capitalization, Mr. Samson was able to check with his mortgage banker. According to Mr. Samson's mortgage banker, the going interest rate for long-term financing was twelve (11 3/4%) percent with a balloon payment at the end of five to ten years. The loan-to-value ratio varied from 70% to 90%. This information was combined with the fact that the general partners' equity investors were expecting a cash-on-cash return before taxes of approximately ten (10%) percent. With this information, the general partners were able to calculate a reasonable capitalization rate for the project:

	PORTION	RATE	WEIGHTED RATE
Mortgage Loan (principal and interest)	75%	.121864*	.09140
Investor's Equity	25%	.100	.02500
	CAPITALIZATION RATE		.11640

Therefore, the economic value was calculated as follows:

$$\text{Economic Value} = \frac{\text{NOI}}{\text{Capitalization Rate}}$$

$$= \frac{\$3,022,500}{.11640}$$

$$\text{Economic Value} = \$25,966,495$$

say $26,000,000

* This number is the debt service constant for 12% amortized over 30 years (refer to mortgage tables).

• **ESTIMATING THE TOTAL SOURCES OF CASH FOR THE PROJECT**

Mr. Samson's mortgage banker's quote of a twelve percent (12%) long-term loan rate was more than just a guess. Mr. Samson had an excellent reputation with several permanent lenders. As a result, his mortgage banker had already been checking around to see what were the best mortgage terms available for a first rate developer such as his client. With Mr. Samson's reputation as a developer, the best mortgage terms available at the time included the following factors and ranges of options:

- twelve percent (11 3/4%) interest amortized over 25 to 30 years;
- loan-to-value ratio ranging from 70% to 90%;
- principal balance would be due and payable upon either the fifth, seventh or tenth anniversary of the loan
- release of loan funds would be tied to a minimum leasing level of 80% (floor loan);
- the net operating income must be sufficient to produce a minimum Debt Coverage Ratio of 1.20; and
- an equity kicker (see Glossary) would be a requirement of the loan either as a portion of net cash flow or as a percentage of net proceeds upon sale of the project.

Based on Mr. Samson's experience with permanent lenders, the Debt Coverage Ratio of 1.20 was an important consideration which would be difficult to reduce. Using the Debt Coverage Ratio of 1.20 as a minimum standard, he set out to negotiate the best mortgage terms for the project. He came up with the following mortgage terms which appeared to be reasonable upon review by his mortgage banker:

- The economic value of the project would be $25,966,495 (i.e. based on Net Operating Income and a Capitalization Rate of 11.64%);

- The long-term mortgage rate would be 11.75% amortized over 30 years (i.e. debt service constant = .121864 (see mortgage tables));

- The principal balance would be due and payable upon the seventh (7th) anniversary of the loan (i.e. balloon payment) with no prepayment penalty;

- Eighty percent (80%) of the loan would be released upon receipt of final inspection from the construction lender and verification that the project had achieved an 80% occupancy rate. Upon achieving a 95% occupancy rate, the remaining 20% of the loan amount would be funded;

- The Debt Coverage Ratio would be 1.27; and,

- No equity kicker would be offered to the lender.

Gonzales and Samson both knew that the absence of the equity kicker for the lender could potentially cause the lender to reject their proposal. They agreed to give up no more than ten (10%) per cent of the net proceeds from the sale as an equity kicker if absolutely necessary to obtain the debt capital. Of course, the ten (10%) per cent would come from their respective share of the net proceeds from the sale (i.e. reduced from 17.5% to 12.5% each). Nevertheless, based on the above stated terms and conditions of the permanent loan assumed acceptable to the lender, the general partners expected the loan amount to be $19,500,000 with an annual debt service payment of $2,376,338. These amounts were calculated as follows:

PERMANENT LOAN AMOUNT

Loan-to-Value Ratio = 75% of $26,000,000 (i.e. economic value)

LOAN AMOUNT = $19,500,000

ANNUAL DEBT SERVICE

$19,500,000 x .1218635 @ debt service constant for 11 3/4%, 30 years

Debt Service = $2,376,338

DEBT COVERAGE RATIO

$$\text{Debt Coverage Ratio} = \frac{\text{Net Operating Income}}{\text{Debt Service}}$$

$$= \frac{\$3,022,500}{\$2,376,338}$$

Debt Coverage Ratio = 1.27

• DETERMINING THE EQUITY CAPITAL NEEDED FOR PROJECT

As will be explained later in this discussion, the total project cost was calculated to be $26,000,000. With Mr. Samson's financial lending contacts, it appeared that raising $19,500,000 in debt capital (11 3/4%, 30 years amort., 7 year term) would not be a major problem. The next question was how best to raise the required $6,500,000 in equity capital.

Upon discussion of this matter among the general partners and their financial advisors, it was decided that the required equity capital for the project had to be raised in stages. It was also recognized that the initial stages would pose greater risk to the investors. It was therefore decided to have two classes of limited partners. The initial limited partners (Group A) would provide the "risk capital" during the real estate development phases leading to obtaining the construction loan.

Upon receipt of the construction loan commitment*, Group A would receive a preferential return for their willingness to accept a greater risk in the project.

The additional limited partner's (Group B) investment would be arranged through a public offering prepared by a reputable syndicator. The equity capital from Group B would be contributed to the project in two parts. Part one of their investment would be pledged upon receipt of the construction loan commitment to the project. Part two of Group B's investment would be committed in the form of a "letter of credit" and only used to cover contingency costs.

• EQUITY CAPITAL CONTRIBUTION ARRANGEMENTS WITH GROUP A

Group A represented ten investors in the 50% tax bracket (six DBEs and four non-DBEs) which were trusted clients of Ms. Gonzales. The following financial arrangement was made with Group A:

- Group A would only be requested to invest if the joint venture partners were successful in acquiring the "development rights" to the North Street Joint Development Project;

- Upon notification of the award of the "development rights" to the joint venture partners, each of the ten limited partners in Group A would contribute $60,000 each for a total of $600,000. This amount of "risk capital" was determined to be the amount needed to take the project through the Final Design and Financing Phases.

- Upon receiving a letter of commitment for construction financing on the project, Group A's limited partners would contribute another $72,500 each for a total investment of $132,500 each and a total group investment of $1,325,000.

*It must be kept in mind that construction loan commitments are only made after the lender is satisfied that all the architectural/engineering plans are ready, all permits to commence construction are in place and most important, a commitment for long-term financing is available to "take out" the construction lender upon completion of construction.

-The following facts and equity requirements emphasize Group A's investment:

a. Partnership was established: December, 1981.

b. Number of partners: 2 general partners; 10 initial limited partners; and an unspecified group of additional limited investors.*

c. Equity capital contributions: general partners ($225,000); initial limited partners ($1,275,000 + $50,000 (organizational fee)); and additional limited partners (estimated to $5,000,000 plus $560,000 syndication fee).

d. Cash assessments: to be covered by general partners only.

e. Cash distributions from operations: initial limited partners to receive a noncumulative, preferential 10 percent return on all equity paid to date. Any excess cash flow to be distributed first to additional limited partners on a noncumulative preferential 8 percent return basis and the remainder distributed 25% to initial limited partners; 74% to additional limited partners; and 1% to general partners.

f. Profits and losses: to be distributed 49% to initial limited partners; 50% to additional limited partners; and 1% to general partners.

g. Sales and liquidation of partnership assets: after payment of mortgage and selling expenses, the initial limited partners are to receive all their equity invested first. The additional limited partners are to receive all equity and assessments second. Any excess is to be distributed 20% to initial limited partners; 45% to additional limited partners; and, 35% to the general partners.

h. Partnership organization fee: to be paid by initial limited partners ($50,000). All partnership reporting and record keeping will be the responsibility of the general partners as part of their management fee.

The investors of Group A were well aware of the risk associated with their investment. They were taking the risk that the project could not only obtain long-term debt financing, but equally important, that it could attract sufficient additional limited investors (Group B) to satisfy the equity requirements of the long-term lender.

* At the time of the original formation of the partnership, the need for additional limited partners was recognized. The specific number of additional limited partners was unknown.

- **EQUITY CAPITAL CONTRIBUTION ARRANGEMENTS WITH GROUP B**

In calculating the total project cost of $26,000,000, the general partners took into consideration the syndication fee which would have to be paid to the syndicator for soliciting and organizing the additional limited investors. Additionally, the total project cost included a substantial, yet reasonable, amount (i.e. $1,560,000) to cover possible under estimation of development cost and working capital deficiencies due to costs exceeding revenues during operation.

Three of the top syndicators in the city reviewed the financial pro formas prepared by the general partners' accountants and architect/contractor. After some negotiation, one of the syndicators agreed to raise $5,560,000 (90% of proceeds to the project and 10% as a syndication fee). The following agreements were made:

- The syndicator would commit to raising $5,560,000 (90% of proceeds to the project) for the project, if and only if, the project could obtain a letter of commitment from a permanent lender for $19,500,000.

- The syndicator agreed to deliver the syndicated amount within six months after construction commenced.

- The additional limited partners (Group B) were included in the partnership created for Group A.

- The following facts and equity requirements emphasize Group B's investment:

a. Initial Partnership was established: December, 1982

b. Number of partners: 2 general partners; 10 initial limited partners (Group A);and 20 additional limited partners (Group B)

c. Equity capital contributions: the additional limited partners agreed to:

--contribute $4,000,000 ($3,440,000 to project and $560,000 to syndicator) in cash --a letter of credit for $1,560,000 to cover contingency expenses.

--if the letter of credit did not have to be used, the additional limited partners agreed to share a portion of their cash flow after preferential allocations, with the general partners getting up to a maximum of an additional 24% of cash flow.

*It was agreed that the syndicator would receive $560,000 as a fee whether or not the "letter of credit" was used.

d. Cash assessments: to be covered by the general partners only.

e. Cash distribution from operations: initial limited partners to receive a noncumulative, preferential 10 percent return on all equity paid to date. Any excess cash flow to be distributed first to additional limited partners on a noncumulative preferential 8 percent return basis and the remainder distributed 25% to initial limited partners; 74% to additional limited partners; and 1% to general partners.

f. Profits and losses: to be distributed 49% to initial limited partners; 50% to additional limited partners; and 1% to general partners.

g. Sales and liquidation of partnership assets: after payment of mortgage and selling expenses, the initial limited partners are to receive all equity invested first. The additional limited partners are to receive all equity and assessments second. Any excess is to be distributed 20% to initial limited partners; 45% to additional limited partners; and, 35% to the general partners.

h. Partnership organization fee: paid by initial limited partners. The syndicator was directly responsible for organizing the additional limited partners (i.e. preparation of offering documents, legal and accounting). These expenses were part of the syndication fee.

• DETERMINING THE TOTAL PROJECT COST

As mentioned in the section discussing the equity capital needs for the project, the development team estimated the total project cost to be $26,000,000. Many factors went into this estimation. First, the hard cost (i.e. building and site improvements) was estimated by the architect in consultation with the proposed prime contractor. Second, the soft cost emerged as a result of much negotiation among the general partners and the development team members. Let us examine these soft costs in more detail.

Although architect/engineering fees range from 3% to 6%, the general partners agreed to pay the architect a relatively higher fee of 5%. This 5% fee was based on a commitment by the architect to assist in the preliminary analysis for no fee and a commitment to prepare the architectural schematics and rendering (i.e. high quality graphic representation of completed project) of the building program for the transit agency solicitation. The architect agreed to only charge $12,000 for this initial work.

The financing fees and construction interest were estimated by Mr. Samson's mortgage broker based on a $19,425,000 construction loan and subsequent permanent loan for the same amount. These costs were established to be as follows:

- Construction Loan

Total Amount (@ 75% of Perm. Loan)	$14,625,000
Average Loan Amount (60% of Loan)	8,775,000
Interest Rate (2 points above prime)	13% (average)
Loan Period	15 months
Loan Origination Fee	1%
Mortgage Broker's Fee	1/2%

- Permanent Loan

Total Amount	$19,500,000
Interest Rate	11.75%
Terms	30 yrs amort., due in 7 yrs
Loan Origination Fee	1%
Mortgage Broker's fee	1/2%

As a precaution against delays in construction and slow leasing of the building's leasable space, Gonzales and Samson decided to include additional "safety" into their cost estimate. First, Samson was confident he could "fast track" the construction schedule in order to complete the project in twelve months. Nevertheless, they wanted to arrange for a fifteen (15) month construction loan. Second, they included the added interest cost for carrying the entire construction loan for an additional three months beyond the fifteenth month. Three, they assumed that the building would only be eighty (80%) per cent leased by the eighteenth month. (NOTE: They assumed that the permanent lender would require a minimum of 80% leases before the "take out" loan would be available. At the 80% lease level, the permanent lender would only provide 80% of the loan; therefore, a plan to cover this "gap" has to be incorporated into the financial strategy at the start). Third, they assumed the building would only be eighty (80%) per cent leased by the eighteenth month. Last, they included an additional amount for miscellaneous expenses and operating deficits.

In summation, the financing fees, construction interest and operating deficits "contingency" amounts were estimated to be as follows:

- Financing Fees	
Construction Loan fee @ 1%	$ 146,250
Mortgage Broker's fee @ 1/2%	73,125
Permanent Loan fee @ 1%	195,000
Mortgage Broker's fee @ 1/2%	97,500
Total Financing Fees	$511,875

- Cost of Loans (Interest Expenses)	
Construction Loan @13%,15mos,avg loan $8,775,000	$1,425,938
Construction Loan @13%,3mos,full loan $14,625,000	475,313
Permanent Loan @11.75%,3mos,80% of $19,500,000	458,250
Total Financing Cost	$2,359,501

- Miscellaneous/Operating Deficits	341,250
TOTAL	$3,212,626
say	$3,212,625

All interest costs shown in the above stated summation, beyond the initial twelve months of construction, were considered to be part of the project "contingency cost". The interest cost for the first twelve months is $1,140,750. The difference between $2,359,501 and $1,140,750 is $1,218,750. This $1,218,750 amount represents the additional amount needed to cover interest cost beyond the initial twelve months. Eventually, the general partners agreed to allocate $1,560,000 in contingency cost for this category ($1,218,750 + $ 341,250). Note the $341,250 amount for miscellaneous operating deficits.

The general partners also went through their own negotiating process to determine their respective marketing/leasing commission fee, developer fee and management fee. It was finally agreed that each partner would take their normal fee rather than reduce their fee in recognition of their added co-responsibility to cover operating deficits on the project. As part of her fee, Ms. Gonzales' commercial leasing and real estate company would be the exclusive marketing and leasing agent for the project. For this service, Ms. Gonzales' leasing commission would be 3.5% of the first year's lease multiplied by the years of the lease (average 5 year leases). Additionally, Ms. Gonzales' real estate firm would be the exclusive agent for the sale of the project seven years hence.

Mr. Samson was not only responsible for 50% of all operating deficits, he was 100% responsible for all construction cost overruns. In addition to his developer fee (4% of total project cost), he insisted on receiving a bonus if he brought the project in on schedule (i.e. 12 months). After some negotiating and discussion among Ms. Gonzales and her limited investors, they agreed to give Mr. Samson a $200,000 bonus if and only if the project was brought in on schedule. Ms. Gonzales was a proponent of this bonus in the discussions with her investors because she knew that if the project came in on schedule, there would be a substantial savings of interest cost. These savings could be used to cover operating deficits, and she would benefit from these savings as a general partner. Nevertheless, Ms. Gonzales was able to get Mr. Samson to consent to accepting only 2.5% fee and no bonus if the project failed to come in on time and therefore required the use of contingency funds (i.e. call for use of letter of credit from Group B overall commitment).

Gonzales and Samson split the management fee (4% of effective gross income) of the project according to the services rendered by each partner in the management of the project. The profits from the management fees were split 50%/50%.

Next, the syndicator fee was negotiated at 10% of all proceeds raised. For this fee, the syndicator (a respected national organization with international investors) agreed to raise $5 million for the project.

The following is a summary of the total project cost.

TOTAL PROJECT COST

TOTAL DIRECT COST:		
SITE IMPROVEMENTS:		
Excavating, paving, curbing	$750,000	
Landscaping	145,000	
	========	895,000
BUILDING:		
Shell 348,000 s.f. (gross) @ $45/s.f.		15,660,000
Tenant Allowance 230,000 s.f. (net) @ $9/s.f.		2,070,000
		============
Total Direct Cost		18,625,000
TOTAL INDIRECT COST:		
Architect & Engineering @ 5% of Construction Cost	931,250	
Testing & Inspections	135,000	
Bonds, Permits & Fees	105,000	
Taxes & Insurance	175,000	
Legal/Closing	190,000	
Financing Fees		
- Construction Loan Interest (75% of Permanent Loan @ $14,625,000 @ 13% @ 15 mos. @ 60%)	1,425,938	
- Construction Loan Fee @ 1%	146,250	
- Permanent Loan Fee ($19,500,000 @ 1%)	195,000	
- Broker's Fee @ 1/2% x (Const. loan + Perm. loan)	170,625	
Marketing @(3 1/2% x $4,455,500 (E.G.I.) x 5 yrs on leases)	779,713	
Developer Fees (guarantees, overhead & profit)	1,000,271	
Syndication Fee @ 10% of capital contribution	560,000	
Interest/Operating Deficits	1,560,000	
	=========	
Total Indirect Costs		7,374,047
		=========
		25,999,047
TOTAL COSTS		say $26,000,000

• THE GO/NO GO DECISION

After three weeks of extensive analysis by the development team and $17,560 in expenses, the general partners were ready to make their decision to go or not go for the North Street joint development site "development rights".

Many uncertainties still existed. How correct were their assumptions about the local market? How good were their project cost estimates? Could they get the permanent lender to agree with their terms and conditions? Could they really raise the equity capital needed? These are the hard questions which the preliminary analysis was to have assisted in answering.

The general partners reviewed their conclusions of the preliminary analysis with their mortgage banker, their syndicator, and their proposed initial group of investors (group A). The limited investors agreed to commit $1,400,000 as per the terms outlined. Based on this commitment and advice of the mortgage banker, Gonzales and Samson decided to go for it.

Based on the financial data and conclusions of the preliminary economic feasibility analysis, the general partners proceeded to refine and package their development proposal. The packaging of the proposal required the following activities:

1. The marketing research consultants prepared a formal market study with supportive data, market demand statistics and recommendations;
2. The general partners and architect carefully refined their building program for the site to comply with all criteria and objectives set forth by the local transit agency for the site;
3. The architect prepared the building program specifications, schematic floor plans, cross sections and designed an impressive rendering of the prepared project;
4. An architectural statement was developed showing how this project was in compliance with the planning and design criteria of both the city and local transit authority;
5. A transportation impact study and analysis was prepared;
6. A detailed development schedule and management plan was prepared;
7. The credential and experience of each consultant and firm on the development team was documented;

8. Detailed pro forma financial statements were prepared for the project;

9. Updated financial statements were prepared on both general partners and three of the initial investors;

10. Tenant commitment letters were obtained;

11. Letters of interest from financial institutions for permanent and construction financing were obtained.

12. A letter from the general partners' syndicator was also included;

13. A Disadvantaged Business Enterprise(DBE) Utilization Plan was prepared;

14. The general partnership documents were finalized.

The entire development proposal was submitted to the local transit agency before the deadline. Of the five development proposals received, Gonzales/Samson's proposal was one of the two final proposals selected for oral interviews before the joint development selection committee of the transit agency. Their proposal was selected.

At this point, the joint venture partners moved into the Final Design and Financing Phase. The financial commitments from the Group A investors were obtained. The architect was given permission to proceed to prepare the final architectural and engineering drawings. The mortgage broker started to line up the requirements of both the construction lender and the permanent lender. The syndicator and the joint venture partners finalized the details of their agreement.

Twelve months after financing was secured, the Construction Phase was completed ahead of schedule and the project was fully leased. Mr. Samson received his $200,000 bonus for completing the project within twelve months, in addition to his 4% developer's fee. Ms. Gonzales received her leasing commissions. Because of the success of both the construction scheduling and leasing program, the $1,560,100 "letter of credit" committed by the additional limited partners did not have to be used. This fortuitous set of circumstances allowed the additional limited partners to make a greater return on their investment and eventually would result in a larger financial return to the general partners.

• SUMMARY OF PRELIMINARY ECONOMIC FEASIBILITY RESULTS

The ability to successfully undertake the North Street joint development project was to a large measure based on the assumptions and financial analysis of the Preliminary Economic Feasibility Analysis. Although assumptions and financial analyses may be modified throughout the course of implementing a project, the initial financial commitments are usually based on the parameters set forth in the preliminary analysis of the project. For this reason, the detailed financial analysis developed by the Gonzales/Samson development team is presented.

The primary objective of the preliminary analysis is to determine if the project can raise sufficient funds to cover all the project costs. The following is a summary of the sources and uses of funds:

EXHIBIT A

SOURCES AND APPLICATIONS OF FUNDS FOR NORTH STREET JOINT DEVELOPMENT PROJECT

Sources of Funds		
Loan proceeds	$19,500,000	
Capital contributions	6,550,000	
	==========	
		$26,050,000
Uses of Funds		
All project development costs:		
Site development costs	895,000	
Construction costs	17,730,000	
Financing costs	3,497,813*	
All other project soft costs	2,315,963	
All syndication costs:		
Legal fees		
Syndication fees	560,000	
Sales commissions		
Developer fees:		
Developer fee (4%)		
Construction guarantee fee	1,000,271	
Operating-deficit guarantee fee (shared equally by general partners)		
	==========	
		$25,999,047
TOTAL PROJECT COST		say $26,000,000

---

*This includes all financial fees, interest during construction and contingency interest cost.

Exhibit B provides a summary of the building program and total project cost.

EXHIBIT B

PROJECT DESCRIPTION

SITE: 24,500 square feet
BUILDING PROGRAM:

- 12 story, plus three below = grade parking levels and a mechanical penthouse
- 348,000 s.f. (Gross) including 10,000 s.f. public space; 70,000 s.f. parking; 230,000 s.f. net rentable area
- spread footing foundation
- poured reinforced concrete frame with 20' x 20' average column bays
- precast concrete panels for exterior skin with dark tinted glazing
- 5" concrete floor slabs
- 5/350 F.P.M. elevators with one cab to basement perimeter, variable air volume with gas-fired boiler and hot water baseboard heat and two packaged A/C units per floor with water side economizer
- basement and retail levels 100% sprinklered
- general office finish - drywall on metal studs, 2'x4' standard florescent light fixtures, carpet allowance - $10/s.y., 2' x 2' reveal edge accoustical tile ceilings
- ceramic tile floor and wainscouting all lavatories
- fifteen month construction projected (fast tracked for 12 months), six month lease-up
- escalator to retail floor provided by local transit agency

TOTAL PROJECT COST

DIRECT COSTS:

LAND: 24,500 s.f. @ minimum lease guarantee of $8/s.f., 4.5% of effective Gross Income

SITE IMPROVEMENTS:		
Excavating, paving, curbing	$200,000	
Landscaping	68,000	268,000
SITE IMPROVEMENTS:		
Excavating, paving, curbing	$750,000	
Landscaping	145,000	
	=======	
BUILDING:		
Architect & Engineering @ 5% of Construction Cost		
	931,250	
	=======	
Total Direct Cost	18,625,000	
TOTAL INDIRECT COST:		
Testing & Inspection	135,000	
Bonds, Permits & Fees	105,000	
Taxes & Insurance	175,000	
Legal/Closing	190,000	
- Construction Loan Interest (75% of Permanent Loan @ 14,625,000 @ 13% @ 15 mos. @ 60%)	1,425,938	
- Construction Loan Fee @ 1%	146,250	
- Permanent Loan Fee ($19,500,000 @ 1%)	195,000	
- Broker's Fee @ 1/2% x (Const. loan + Perm. loan)	170,625	
Marketing @ (3 1/2% x $4,455,500 (E.G.I.) x 5 yrs on leases)		
Developer Fees (guarantees, overhead and profit)	1,000,271	
Syndication Fee @ 10% of capital contribution	560,000	
Interest/operating Deficits	1,560,000	
	=========	
Total IndirectCosts		7,374.047
		=========
TOTAL COSTS		25,999,047
		Say $26,000,000

163

The economic analysis of the project is presented in Exhibit C. The purpose of this analysis was to calculate the cash flow or Net Operating Income (NOI) available for establishing the "economic value" of the project. The actual debt capital available to the project was based on the lending criteria set forth by the permanent lender (i.e. loan-to-value ratio, debt coverage ratio, etc.).

EXHIBIT C

ECONOMIC ANALYSIS OF PROJECT

INCOME:		
200,000 s.f.(office) @ $19/s.f.	=	$3,800,000
30,000 s.f.(retail) @ $21/s.f.	=	630,000
65,000 s.f.(parking) @ $4/s.f.	=	260,000
10,000 s.f.(public space) @ $0	=	-0-
		==========
POTENTIAL GROSS INCOME		$4,690,000
VACANCY (5%)		234,500
		==========
EFFECTIVE GROSS INCOME		4,455,500
EXPENSES:		
200,000 s.f. @ $5.75/s.f.;		
30,000 s.f. @ $2.75/s.f.		
plus 4.5% Effective Gross		
Income to Local Transit Agency		1,433,000
		==========
NET OPERATING INCOME(NOI)		$3,022,500

DEBT AVAILABILITY ANALYSIS

$$\text{Economic Value} = \frac{\text{NOI}}{\text{Caplization Rate}} = \frac{\$3,022,500}{0.11640} = \$25,966,495$$

PERMANENT LOAN FROM INSURANCE COMPANY

Loan-to-Value Ratio = 75% of Economic Value
Debt Capital = 75% x $25,966,495 = $19,474,871
say $19,500,000

DEBT SERVICE

$19,500,000 x .1218635 @ debt service constant for 11 3/4%, 30 years
Debt Service = 2,376,338

$$\text{Debt Coverage Ratio} = \frac{\text{NOI}}{\text{Debt Service}} = \frac{3,022,500}{2,376,338} = 1.27$$

Once the total project cost was estimated and the available debt capital was determined, the difference became the amount of equity capital needed in order to make the project economically viable. Knowing the amount of equity capital needed was one thing, getting real commitments for this equity capital was more difficult. As stated within the case study, two classes of limited partners were deemed most appropriate for this project. The following exhibits emphasize the financial analysis undertaken by Gonzales/Samson in determining the total financial benefits obtained by the limited partners. This period covers the entire investment cycle of seven years to include the dissolution of the limited partners upon sale and disbursements of proceeds.

EXHIBIT D

SUMMARY OF TOTAL DISTRIBUTION OF BENEFITS

PARTNERS	EQUITY INVESTMENT	CASH FLOW	NONCUMULATIVE PREFERENTIAL*** CASH ON CASH BEFORE TAX RETURN	TAX BENEFITS	PERCENTAGE FROM NET PROCEEDS FROM SALE (10 YEARS)
Ms. Gonzales	$ 25,000	.5%	0%	.5%	17.5%
Mr. Samson	$ 200,000*	.5%	0%	.5%	17.5%
Lender	0	0%	0%	0.0%	0.0%
Limited A	$1,325,000	25%	10%	25.0%	20.0%
Limited B	$5,560,000	74%	8%	74.0%	45.0%
TOTAL	$7,110,000**	100%		100.0%	100.0%

* It should be noted that the developer structured his equity investment of $200,000 in such a way that he received a bonus of $200,000 if he was able to deliver the project on schedule. How reasonable such an arrangement is must be weighed against the potential cost to all investors if the project is delayed.

** This total is the amount of investment capital contributed to the project. Of this total amount, $50,000 was used for organization cost and $560,000 was used for commission to the syndicator. Nevertheless, the limited partners (Group A and Group B) received returns on their entire investment.

*** The initial partners will receive a noncumulative preferential 10 percent return on all their investment paid to date of distribution. Any excess cash-flow will be distributed first to the additional partners (Group B) on a noncumulative preferential 8 percent return on their investment to date of distribution. The remainder will be distributed 25% to initial limited partners and 74% to Group B. One percent will be distributed to general partners.

- **LESSONS LEARNED**

This case study was based on an actual project. It was modified to highlight some of the most important considerations by DBEs in pursuing equity ownership opportunities in transit-related real estate development projects. Based on the information provided, the following lessons can be take from this experience:

1. Local transit agency joint development policies which encourage and promote DBE participation in all aspects of joint development project implementation are a necessary prerequisite. Without these pro-DBE joint development commitments, it will be difficult at best to have DBE compete with non-DBE firms on major joint development projects and access equity ownership opportunities. Therefore, a pre-condition for DBE equity ownership participation in joint development projects is a commitment by local transit agencies to implement minimum requirements on DBE equity ownership.

2. In order for DBEs to successfully participate in the equity ownership and business opportunities created by a joint development project, local transit agencies must not only have joint development policies which promote participation; they must have agency staff assigned to implement these policies. For example, in this case study, the local transit agency was unprepared to address the problems of DBE construction bonding and the identification of potential DBE investors. Without proper planning and qualified agency staff to implement DBE joint development policies, these policies may well prove to be ineffective.

3. DBEs interested in <u>actively</u> participating in equity ownership joint development opportunities must know their personal strengths and weaknesses. These personal resources must be complemented with the resources of others to form a credible development entity. Ms. Gonzales' success, in this case, was due to her ability to identify a partner, Mr. Samson, whose resources added to hers. Her resources also enhanced his strengths. This matching of resources also applies to the matching of financial objectives of both the general partners and limited partners.

4. Organizing your development entity (general partners and limited partners) requires a thorough understanding of the development process and financial life cycle of the investment. Knowing the development process will assist in anticipating and calculating costs throughout the project. Knowing the life cycle of the investment will help in allocating the benefits of the project among the general and limited partners. Ms. Gonzales could not have been able to negotiate a joint venture partnership agreement and structure the participation of her limited partner investors without this knowledge.

5. As a general rule, developers do not like to joint venture as general partners with individuals with little or no knowledge of real estate development. If you are a DBE investor with an interest in real estate investments but with little direct knowledge of packaging and implementing real estate projects, it is better to identify a qualified experienced developer to act on your behalf.

6. As a DBE general partner and equity owner in a joint development project, you are in a position to influence who joins your development team. Too often, DBE contractors will be denied participation in major real estate development projects because they lack the experience or bonding. One way of providing opportunities for DBE contractors, architects, attorneys, etc. to break into major projects is to require your prime contractors to joint venture with smaller DBE firms. This can work if and only if the DBE joint venture contractor can carry his/her own weight in the project. Carefully select your entire development team. Lenders and investors will be looking to the credibility and experience of your development team.

7. Never assume that the local transit agency's analysis of a joint development site is without fault! Their analysis of the site may be correct but outdated or simply wrong. Therefore, it is absolutely essential that your development team end avor to work out any disagreement with the transit agency on the site before the prospectus is finalized and "on the street". Most often the transit agency will be cooperative in listening to your concerns.

8. Carefully read and comply with the prospectus. Obtain as much information and clarification on the prospectus as possible. By all means attend all pre-bidding conferences.

9. Be prepared to undertake a "preliminary economic feasibility analysis of the project. It is a valuable way to systematically evaluate your assumptions about the local market, type of complex needed, expected income, sources of debt financing, sources of equity capital, and, total cost of project. Irrespective of the method used, the information just mentioned is an essential prerequisite to your decision to pursue equity ownership in a joint development project.

10. As a limited investor, you have a right to demand to see a financial analysis of the project. Don't invest in any real estate development opportunity unless you are provided with sufficient information upon which to evaluate both the benefits and risks of your investment.

11. New construction projects are always risky and therefore those investors who provide the "risk capital" to get the project through the construction phase should expect to obtain a higher rate of return on their investment (i.e. limited partners group A) than those investors who invested after the project was financed or constructed. Return on investment should be weighted against the risk of the investment.

12. The general partners should avoid the temptation to under value their contribution to the project. If the project can not afford a reasonable fee to thedeveloper andgeneral partners, it may be in the best interest of all to walk away from the deal. The project must have built-in financial incentives to motivate the active participants (developer and general partners) to deliver. Minority/women investors must expect to pay reasonable fees for services rendered but should not expect to pay reduced rates for top qu ity services.

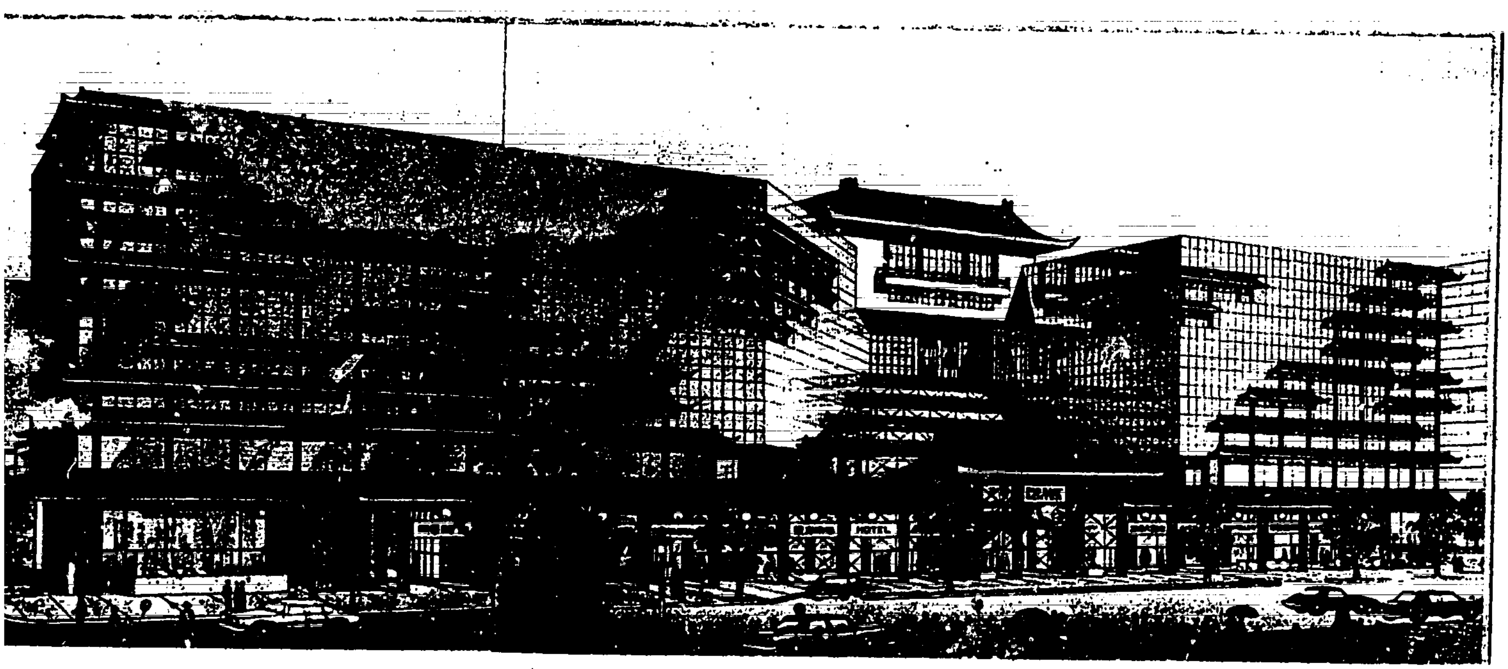
APPENDIX TWO

CASE STUDY TWO: NORTH GALLERY PLACE, WASHINGTON, D.C.

OVERVIEW

On May 15,1983 North Gallery Place Associates received the joint development rights to the Gallery Place North transit station site from the Washington Metropolitan Area Transportation Authority (WMATA). In many ways the efforts of North Gallery Associates represents an achievement of major proportion. For the first time in the history of WMATA's joint development program a group of minority entrepreneurs have acquired a controlling interest in a major transit-related real estate development project. Exhibit I provides a pictorial presentation of the $130 million plus Far East Trade Center commercial and residential complex proposed for this joint development site.

EXHIBIT I



FAR EAST TRADE CENTER
(Gallery Place North Joint Development Project)

The purpose of this case study is to illustrate how minority entrepreneurs, in this case members of Washington, D.C.'s Chinese community, were able to plan, organize and obtain the necessary capital to acquire the development rights to the Gallery Place North joint development site. Three major points are explained in this case study. First, it charts the long-term commitment of time and financial resources necessary to interest and organize minority/women community investors. Second, it demonstrates how minority entrepreneurs combined their financial resources to achieve majority ownership and control over the design and implementation of a transit site. Third, the case study underscores the importance of the local transit agency's commitment to equity ownership opportunities in joint development.

BACKGROUND

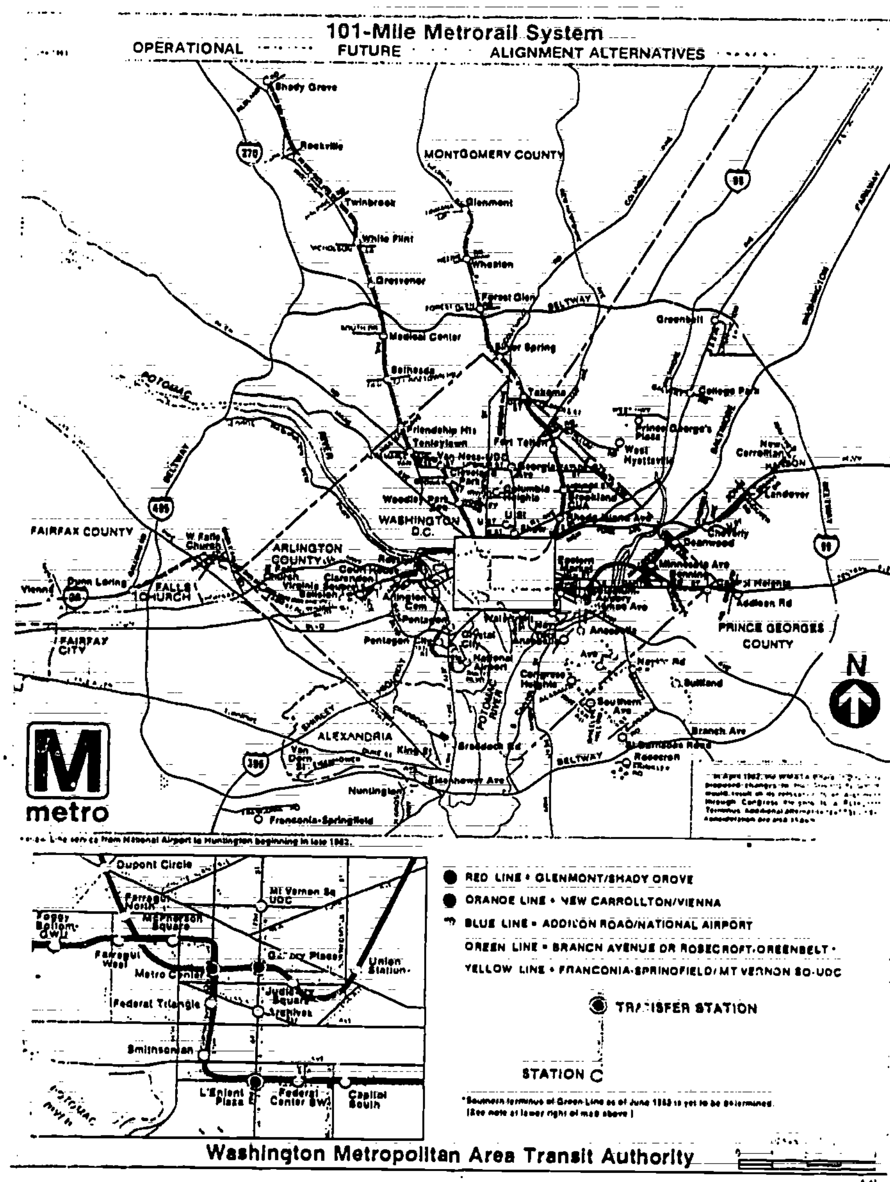
The metropolitan Washington area consists of the District of Columbia and the adjoining suburbs of Maryland and Virginia. Together the Washington, D.C. metropolitan area has a population exceeding 3 million persons with thirty-five percent of its residents being minority. Within the District of Columbia, seventy-six percent of the city's residents are minority.

In economic terms the region's urbanized areas is one of the wealthiest in the nation. Metropolitan Washington, D.C. has one of the highest concentrations of scientists and engineersin the United States. Between 1978 and 1984, high technology firms and financial institutions moving into the area multiplied dramatically. Notwithstanding this impressive growth, the region's minority population continues to suffer from high unemployment and the lack of adequate housing.

During the late 1960s public officials recognized the importance of a public rapid mass transit system to the area's future growth and development. In 1968 a regional metrorail system was proposed and approved by Congress. The system would be managed and operated under the jurisdiction of an interstate agency called the Washington Metropolitan Area Transit Authority (WMATA). The board of directors of WMATA consists of elected officials from the District of Columbia and the adjoining jurisdictions of Maryland and Virginia.

Currently metrorail operates a 42.4 mile system which is expected to expand to a 70 mile system serving 63 stations by 1987 (refer to Exhibit II, Regional Map). The system extends from Vienna, Virginia to New Carrollton, Maryland on the Orange Line and from Huntington, Virginia to Addison Road, Maryland on the Blue Line. The recently completed Yellow Line Shuttle extends from Gallery Place and Gallery Place North (i.e. site of this case study) to National Airport. On an average day the system's ridership exceeds 300,000 trips. Metro also operates bus transportation with an average ridership exceeding 350,000 trips. When the

EXHIBIT II



WMATA METRO REGIONAL MAP

system is completed it is expected that the number of trips will double. Already 31,000 fewer cars per day enter the downtown central business district as a result of current system operations.

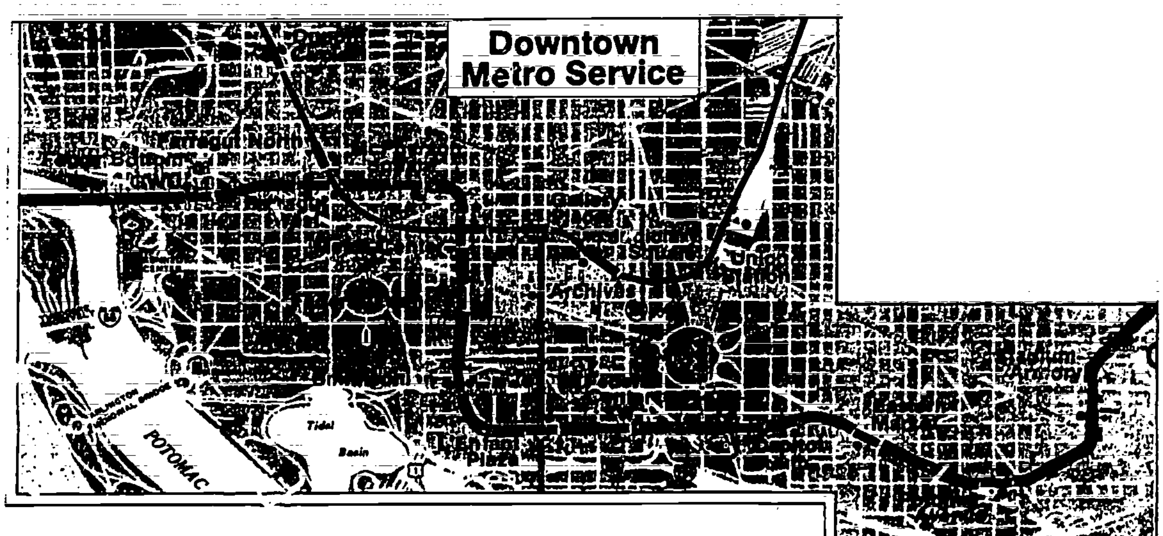
On a regional basis WMATA has placed a major emphasis on joint development efforts as a means of stimulating economic development and recapturing some of the cost of building the system. WMATA's joint development program is recognized as a leading example of a local transit agency's commitment to effective participation by minorities and women in the equity/ownership aspects of transit-related real estate development. To that end, WMATA has institutionalized policies which require the equitable participation of businesses owned and controlled by minorities and women in all aspects of joint development activities (refer to Appendix Two for an example of WMATA's joint development prospectus and DBE plan).

SITE LOCATION AND CHARACTERISTICS

The Gallery Place North joint development site is located east of 7th Street, N.W. between G and H Streets, N.W. The site is at the visual center of Chinatown and situated within the physical center of downtown. Most important, the site is strategically located within the metrorail system as the starting point for the new shuttle (opened 1982) to National Airport (refer to Exhibit II, Regional Map).

Exhibit III illustrates the project's distinctive urban location. Gallery Place North is approximately two blocks east of the recently opened Washington Convention Center and the Martin Luther King Jr. Library. To the south, the site is surrounded by the National Portrait Gallery and the National Museum of American Art. Also, south of Gallery Place is the Pennsylvania Avenue development area. Proposed for this development area is a mix of uses including housing, offices and specialty retail stores. The White House is located less than one mile away from the Gallery Place North site.

EXHIBIT III

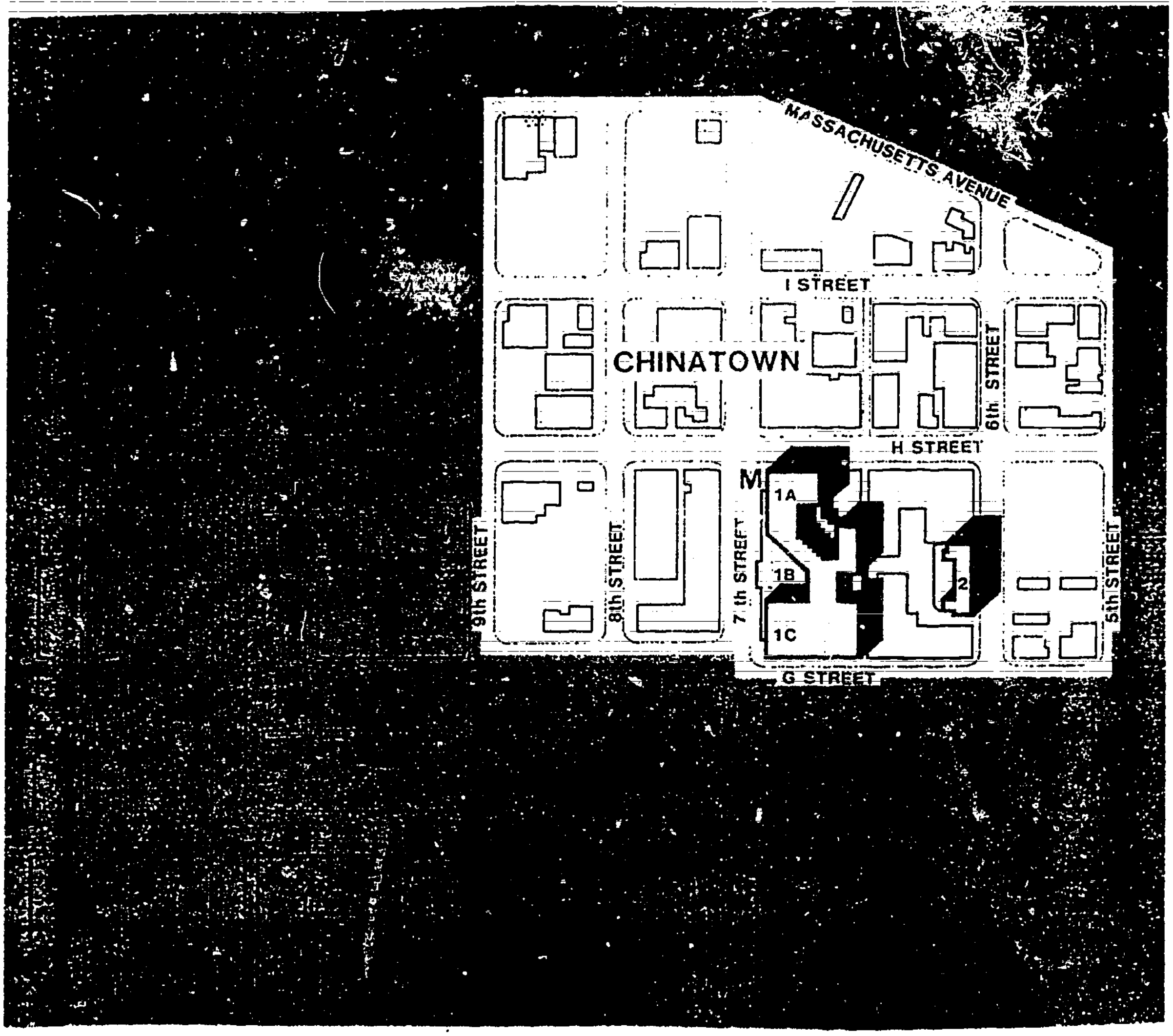


Urban Location of Gallery Place North Site

PROPOSED BUILDING PROGRAM

The proposed building program for the Gallery Place North site calls for a unified mixed use development composed of hotel, retail, office, residential, and art, cultural and entertainment facilities. Exhibits IV, V and VI provide a graphic display of the proposed building program and site configuration of the building complex.

EXHIBIT IV



FAR EAST TRADE CENTER SITE PLAN

PRELIMINARY PROJECT BUILDING PROGRAM DATA:

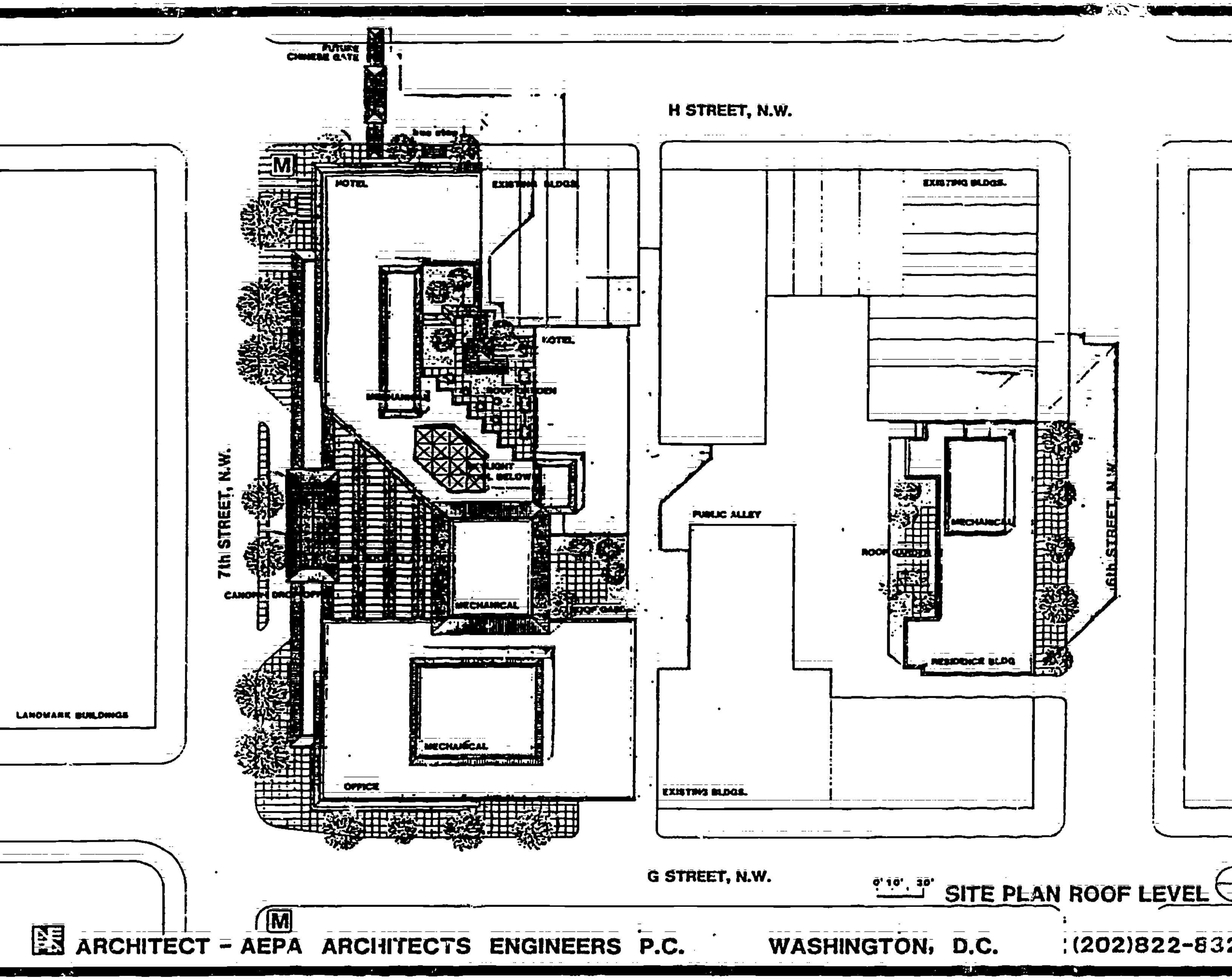
Joint Development Project Name: Far East Trade Center

Land Area . . . . 113,923 s.f.

Proposed Facilities (subject to change):

1.A. Hotel	426,000 s.f.	(531 rooms)
1.B. Retail	197,800 s.f.	
1.C. Office	219,200 s.f.	
2. Residential Building		
Apartments	165,000 s.f.	(170 condominiums)
Retail	10,000 s.f.	
Parking	632 car spaces	

EXHIBIT VI



FAR EAST TRADE CENTER PLAN VIEW

PROJECT HISTORY

The area surrounding the Gallery Place North joint development project is in the heart of the downtown retail district of Washington, D.C. As envisioned in the original plan developed by L'Enfant, the area around Gallery Place was to be the focal point for a well ordered commercial district. In the early 1900s Gallery Place served this purpose well with many major department stores, shops, and prominent hotels. Around the mid 1930s the commercial vitality of Gallery Place was enhanced with the emergence of a thriving Chinatown community. Chinatown is a mixed-use community, incorporating retail, service, residential and cultural institutions. Although a relatively small number of Chinese-Americans actually reside in Chinatown, the area is the commercial and cultural center for a much larger metropolitan Chinese community.

During the 1960s and 1970s much of the commercial vitality of Gallery Place and Chinatown was drained by twenty years of suburban competition. Although department stores were attracted to the Washington, D.C. metropolitan area, they were not locating in the central business district. As a result, retail sales in downtown stores diminished year by year starting in 1958 and continuing through the early 1970s.

As early as 1972 the City Council for the District of Columbia approved plans for an urban renewal corridor from the center of downtown (12th and G Street) along G Street to the center of Chinatown (7th and G Street). The urban renewal sites along the G Street corridor included Gallery Place and North Gallery Place transit stations. It was assumed, at the time, that the G Street corridor's proximity to rapid rail service would make the sites more attractive for development. These early efforts, while commendable, failed to result in the anticipated economic revitalization. It is important to note that these initial urban renewal plans also failed to address the ethnic and cultural character of Chinatown.

This insensitivity to the preservation of Chinatown was even more marked in subsequent downtown revitalization studies. One study, conducted by a land use planning consultant from the Midwest, tended to negate the existence of a viable Chinatown community by noting that it be confined to two storefront city blocks along 7th Street. Such recommendations were contrary to a vision of Chinatown as a major anchor for tourism and a focal point for the entire metropolitan Asian community.

The existence of Chinatown was further threatened by major developers in the mid 1970's. These developers wanted to use the Chinatown neighborhood area to build hotels which would serve the proposed convention center two blocks away from Chinatown. In their arguments to the City Council, some developers denied the existence of Chinatown. This lack of sensitivity and commitment by local developers was the impetus which was to lead the Chinese

community to organize under the leadership of Alfred L. Liu, A.I.A. (architect/urban planner), Dwan L. Tai, Ph.D. (developer/economist) and Dr. William Chin-Lee, M.D. (community and political leader) to revitalize Chinatown around the North Gallery Place joint development site.

In order for the District of Columbia to actively promote the revitalization of Chinatown, the Chinese community itself had to boldly set forth the arguments for sustaining and nurturing a Chinatown within the Capital City. Mr. Liu and Ms. Tai provided the leadership for this effort. They enlisted the resources of their respective firms (AEPA, Architects Engineers, P.C., and Capital Professional Center, Inc.) to produce and circulate a planning concept paper entitled "The Future of Washington's Chinatown: Extinction or Distinction." The concept paper noted the special character of Washington, D.C.'s Chinatown as a distinct ethnic and cultural community with definite geographic boundaries. The paper further noted the economic decline of Chinatown and indicated its potential as a significant tourist attraction for the Washington, D.C. metropolitan area. A key conclusion of this report was that the potential for the revitalization of Chinatown was unique and that "the Metro joint development project (i.e. North Gallery Place) alone can 'make' or 'break' Chinatown".

This concept paper was used as a rallying point by the Chinese community. They presented and discussed the implications of the paper as a guide to Chinatown's future growth at various business and community meetings. The paper was discussed extensively with the District's planning department and planning offices. For the first time the future role of Chinatown as major anchor for downtown Washington was defined. Liu and Tai also discussed and promoted support for their concept among members of the Greater Washington Board of Trade to enlist broad business community support. After eighteen months and thousands of documented person-hours spent in meetings, Liu and Tai had achieved some success in promoting their concept of a revitalized Chinatown. The city planning department accepted, in principle, the idea of establishing specific development objectives for Chinatown and the concept of policies, including chinese design features, which would reinforce the definition and identity of Chinatown as a special cultural district. Although the Chinatown objectives were not explicitly stated until later when they were incorporated into the District of Columbia Comprehensive Plan Act of 1984 (D.C. Law 5-76), Liu and Tai did refer to city planning department support in their discussions with the WMATA staff.

Liu and Tai requested a meeting with WMATA's joint development staff in early 1981. The purpose of the meeting was to discuss the importance of the Gallery Place North site to the overall revitalization of Chinatown. They stressed the need for developing a joint development project on the site which would be distinctly Chinese in design and character. Such a project would

benefit both WMATA and Chinatown by giving the city a distinctive tourist attraction which combines hotel, retail, office and residential space. Furthermore, such a project could entice the establishment of U.S. offices of Asian corporations in and around the project as well as encourage foreign investment in the area from the Far East. The joint development staff was very interested in their presentation but no commitment was made at that time to incorporate their recommendations into the upcoming solicitation for proposals on the Gallery Place North site.

Years of commitment of time, money and perseverance paid off for Liu and Tai in 1982. In that year, after several years of careful deliberation, the Mayor's Downtown Committee unveiled its much awaited "Recommendations for the Downtown Plan" (the "Plan"). Among the many issues discussed, the Plan noted the crucial role that Gallery Place in general, and the joint development site in particular, must play in the revitalization process of downtown.

In keeping with its overall conclusion the Plan proposed that the following development objectives be established for the site:

- Develop the Gallery Place area as a special focal point in the City with major functions as a specialty retail market place and a center for arts and cultural activities.
- Establish a special ethnic district that will enhance both the Chinese community and the Downtown.
- Ensure the presence of a critical mass of land use consisting of ethnically oriented groundfloor retail, substantial housing and office space, community facilities and hotel use as appropriate.
- Develop the physical design criteria for new and rehabilitative projects within the special district that will reinforce the definition and identity of Chinatown.

On August 23, 1982 WMATA released its prospectus for Gallery Place North. In it WMATA established the following development objectives for the site:

- The plans must reflect development of the site to the highest and best economic use.
- The plans for development must reflect excellence in architectural design and site treatment to encourage maximum use of the Metro system and the related potential for the site.

- The plans for development must provide functional and aesthetic integration of Metro facilities.

- The plan must be responsive to special planning and design criteria, including the implementation of District planning objectives.

- The plans for development must provide a unified development, incorporating the WMATA and Bergman properties (adjacent lots).

More important, the WMATA prospectus established a clear relationship between the site and Chinatown. Noting this concern, the WMATA prospectus indicated that the design criteria for the site must reflect the character of an enhanced Chinatown. According to WMATA "the development must recognize the importance of H Street as the 'main' street of Chinatown and the corner of Seventh and H Streets as a 'gateway' for the community". WMATA added that the proposal for the site "should consider the suitability of design with a Chinese character at these locations".

ORGANIZING FOR DEVELOPMENT

When WMATA released its long awaited prospectus for Gallery Place North, several preconditions for the development of the site had been achieved by the Chinatown community. First, development objectives which recognized the benefits of an enhanced Chinatown to Washington, D.C. were established. Second, specific boundaries for Chinatown were recognized. Third, architectural standards reflective of an enhanced Chinatown were encouraged for the joint development site.

The responsiveness of WMATA to community concerns, as reflected in its prospectus for North Gallery Place, proved to be the needed catalyst in mobilizing community interest in the site. Thus, by the time that WMATA released its long awaited prospectus, several community groups were interested. One group--the Capital Chinese Development Corporation--under the leadership of Alfred H. Liu was organized and incorporated in early 1982. The other--the Chinese Economic Development Corporation --headed by Dr. William Chin-Lee--was organized and incorporated later.

The apparent division in the community was cause for concern for all and in particular Liu and Tai. After their years of work and financial sacrifice to help create the opportunity to pursue the equity ownership and control of the Gallery Place North site, the Chinese community was split over who among them should go after the development rights.

Given the importance of the joint development site to the

revitalization of Chinatown, it was recognized that the Chinese community must pursue this opportunity together. In order to reach harmony and cooperation, efforts were started to bring the two groups together. A key consideration in this effort was the creation of a new organization under the chairpersonship of Dr. Chin Lee. Key positions on the Board of Directors of the new organization would be offered to members of both groups. Thus, as the price for achieving harmony, Liu and Tai gave up their decision-making control over the project and opened it up to community control. Further, Liu and Tai gave up any "deal packaging equity share"* rights for bringing the deal to the Chinese community. For the sake of the project, they decided not to insist on the normal equity share in the project for their services but to base their equity participation mainly on cash contribution alone.

On December 8, 1982 a reconstituted organization was formed. The Chinatown Development Corporation (CDC), as the new organization would be called, was composed primarily of former members of the previous two groups. With Dr. Chin Lee as chairperson and Alfred H. Liu as vice-chairperson, CDC established the strengthening of Chinatown "as an integral ethnic community of the metropolitan area" as its primary goal.

CDC was organized as a corporation. This form of organization was chosen primarily to give every one of the Chinese community investors a voice in the decision-making. Immediately upon its organization CDC elected a board of directors to manage and conduct its day-to-day affairs. The capitalization of the corporation was based on $100.00 per share and would eventually reach $237,000. The formation and capitalization of CDC was an important first step in raising the necessary "risk capital" to allow the Chinatown community to effectively participate in the joint development marketplace.

Having organized, CDC members made major efforts to attract a prominent developer as a venture partner in the project. During this process, Ms. Tai alone contacted approximately thirty developers throughout the country. In retrospect, there were two reasons why major developers did not consider this project a high priority opportunity. First, few developers understood the Chinese community. The idea of taking on 34 "general partners", along with the design requirements of the project, added

*In commercial real estate projects, it is common for the organizers of the project to obtain an "equity share" in the project based on their time and expenses incurred in creating and taking the initial risk to develop the pre-conditions to bring the project to a certain stage.

complexity to an already complex venture (i.e. implementation of major real estate ventures). Second, all of the local major developers were struggling with the recession of 1982. Washington, D.C., like many other metropolitan areas at the time, was suffering from an oversupply of office and hotel space. As a result, local major developers were overcommitted to their existing projects.

With time running out by which to respond to WMATA's prospectus and with no major developer committed to joint venture the project, Mr. Liu took the initative and began to develop the building program for the site. In this regard CDC was fortunate in having as a member of the corporation a local architect who was a creative designer and knew the community and its needs. Dwan Tai contributed her knowledge of local commercial markets and real estate finance and prepared the initial conceptualization of probable markets and trends. While Liu and Tai were undertaking the preliminary steps towards formalizing a concept and building program for the site, efforts to identify an interested developer continued.

One of the individuals with whom Liu and Tai spoke regarding the need to identify a prominent developer for the project was a local attorney, Mr. Robert Stein, with extensive experience in the legal aspects of real estate development. Mr. Stein presented Mr. Liu with an of[illegible]e a general partner with CDC. Part of this offer in[illegible]ringing in a third general partner with commercial d[illegible]ment experience, risk capital, and a strong financial sta[illegible]t. This third partner was Mr. Charles Luria. The proposed general partners met and an agreement was reached. A Memorandum of Understanding was prepared and signed by the general partners. During the process of reaching an agreement among the general partners, limited partners were also agreed to. The Memorandum of Understanding was the first written document of the limited partnership included in the preparation of the proposal to WMATA.

DEVELOPMENT PROPOSAL PREPARATION

The difficulty of organizing the CDC and the process of identifying joint venture general partners took an inordinate amount of time. By the time the Memorandum of Understanding was signed by the general partnership, it was apparent the development entity (now called the North Gallery Place Associates (NGPA)) would be unable to meet the 90 day submission period established by WMATA. A ninety day extension was requested by NGPA and granted by WMATA to all interested parties.

Many things still had to get done in a very short period of time. Foremost in the minds of the development entity was the completion of the necessary financial feasibility analysis. Alfred Liu's building program was submitted to a financial

to endorse the project. Liu and Tai were instrumental in this effort. As a result, NGPA put together the "who's who" of Washington, D.C.' real estate development consultants and contractors and also received letters of support from several local financial institutions.

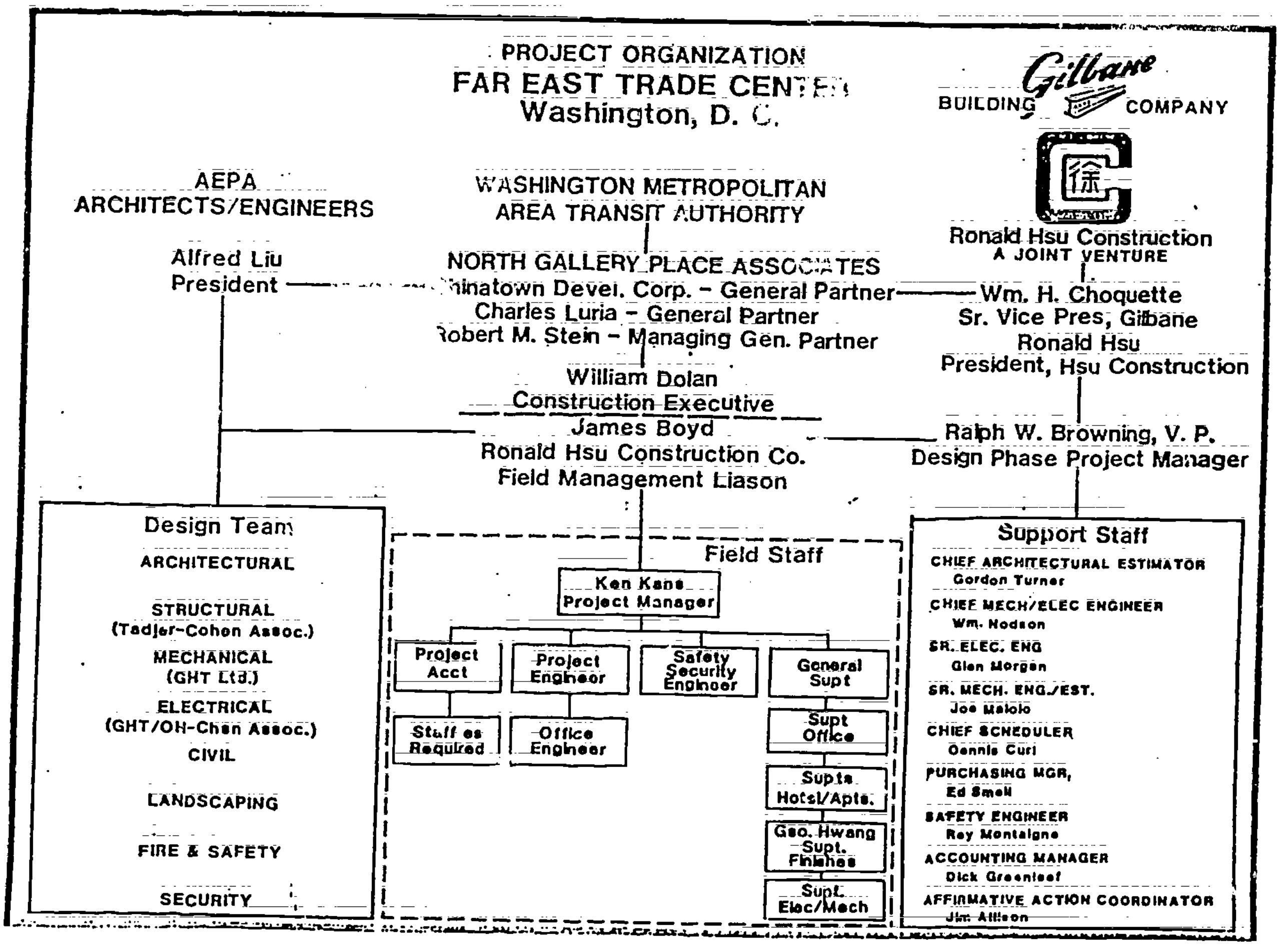
Equally important, CDC was able to insist that Chinese contractors be involved to the maximum extent in every phase of the project. As a result, NGPA put together one of the strongest development teams possible from the local area with the added inclusion of qualified Chinese minority firms as part of the NGPA development team. Exhibit VII described the NGPA development team for the proposed Far East Trade Center project. Exhibit VIII describes how the development team was organized for the construction phase of the project.

EXHIBIT VII

FAR EAST TRADE CENTER PROJECT TEAM

Developer:	North Gallery Place Associates a District of Columbia Limited Partnership
	Chinatown Development Corporation Charles Luria Associates Robert M. Stein Jung & Bryant Alfred H. Liu Linowes & Blocher Investment No. VI
Developer Consultant:	Southwest Development Co., Inc. a subsidiary of: Bresler and Reiner, Inc. Washington, D.C.
Architects:	AEPA Architects Engineers, P. C. Alfred H. Liu, A.I.A., President Washington, D.C.
Structural Engineer:	Tadjer-Cohen Associates Silver Spring, Maryland
Mechanical Engineer:	GHT Limited Arlington, Virginia
Electrical Engineers:	GHT Limited Arlington, Virginia
	On-Chen Associates Kensington, Maryland
Contractors:	Gilbane Building Company Providence, Rhode Island Landover, Maryland
	Ronald Hsu, Construction Capitol Heights, Maryland
Economic Consultant:	Delta Associates Alexandria, Virginia
Transportation Consultant:	Gorove/Slade Associates, Inc. Washington, D.C.

EXHIBIT VIII



FAR EAST TRADE CENTER ORGANIZATION

STRUCTURE FOR CONSTRUCTION PHASE

Financial institution support for the project was also extremely important. The NGPA development entity was able to obtain several letters of interest from prominent local banks. At Liu and Tai's insistence, the NGPA development entity was able to enhance the financial strength of their development entity before the eyes of WMATA by obtaining a letter of interest from a respected equity capital investment company, Bresler and Reiner, Inc. The inclusion of Bresler and Reiner's financial statement in the proposal strengthened the financial credibility of the NGPA development entity.

In addition to identifying professional and financial support for its development team, NGPA included as part of the development proposal a plan for meeting Disadvantaged Business Enterprise (DBE) utilization. This element of the proposal was considered important in light of WMATA's requirement that proposals include minority participation in the following areas: equity participation, contracts for professional services, construction contracting, purchasing of materials and supplies, and building leasing and management. Noting the location of the project within the City and Chinatown, WMATA added special emphasis on DBE participation in the project.

On the issue of DBE participation NGPA response was strong. With respect to equity participation, NGPA easily met WMATA's twelve percent participation requirement as CDC was the majority general partner with forty-seven (47%) percent of the equity. DBE participation during the development period of the project was addressed through the establishment of a joint venture between a minority-owned and a majority-owned construction firm. In the area of non-construction service, such as leasing and advertising, CDC indicated its intention to form a leasing subsidiary which will share responsibilities with a non-minority leasing management firm. Overall, NGPA indicated in the proposal that the partnership agreed to the fullest extent possible to utilize members of the Chinese community in the development, construction, real estate management, leasing maintenance and other related activities of the project.

Exhibit IX provides a breakdown of the percentage ownership among the initial development entity participants (general partners and limited partners). This exhibit also shows the amount of initial risk capital invested by the participants for a transit-related real estate development project of this magnitude.

EXHIBIT IX

LIMITED PARTNERSHIP AGREEMENT
AND
CERTIFICATE OF LIMITED PARTNERSHIP
OF
NORTH GALLERY PLACE ASSOCIATES

GENERAL PARTNERS	AGGREGATE AMOUNT OF CAPITAL CONTRIBUTIONS	PERCENTAGE OF PARTNERSHIP AGREEMENT
Chinatown Development Corp. 2423 Pennsylvania Avenue N.W. Washington, D.C. 20037	$250,000.00	47%
Charles Luria Associates 300 Army-Navy Drive Arlington, Virginia	$150,000.00	28.2%
Robert M. Stein ?01 North Beauregard Street Alexandria, Virginia 22312	None	18.8%

LIMITED PARTNERS	AGGREGATE AMOUNT OF CAPITAL CONTRIBUTIONS	PERCENTAGE OF PARTNERSHIP INTEREST
Jung & Bryant 1320 19th Street N.W. Washington, D.C. 20036	$12,500.00	2%
Linowes & Blocher Investment No. VI 1025 Connecticut Avenue N.W. Washington, D.C. 20036	$12,500.00	2%
Alfred H. Liu 2421 Pennsylvania Avenue N.W. Washington, D.C. 20037	$12,500.00	2%
TOTAL	$437,500.00	100%

DEVELOPMENT PROPOSAL

The proposal submitted by NGPA provided for a development program which gave careful consideration to the objectives established by WMATA (Refer to Appendix II, Gallery Place North Joint Development Prospectus). NGPA's preliminary program, subject to later market studies, called for a mixed-use development with an oriental motif. Included as part of the program were plans for a 531-room hotel to be built on the site's 7th and H Street corner above the rapid transit station. An office component consisting of 219,000 square feet was included to be marketed to private sector institutions primarily from Far East nations. As noted in the NGPA proposal, the District of Columbia prov[illegible] no single location in which Far East trade and financial ins[illegible]tions receive special attention. Ground floor facilities in the office building were to be devoted to 197,000 s.f. of retail space with special emphasis on festive ethnic shops. A 170-unit residential building is also to be developed along with a 632-space garage. When completed the development program calls for a total of 1,274,350 gross square feet of space.

In addition to the architectural program, the proposal submitted by NGPA provided a financial analysis of projected costs and revenues. These were prepared in accordance with several specifications outlined by WMATA in the prospectus. First, WMATA--not sure if the selected development entity would be able to negotiate rights to the adjacent Bergman properties--required that any pro forma financial analysis be based on a minimum development of 432,000 feet of gross floor area or the maximum allowed for Lot 44. Second, WMATA required that pro forma statements project the annual gross income and net cash flow of the project for ten years beginning with the initial year of occupancy. Third, WMATA required that "developmental period rents" be paid for three consecutive years while the project was under construction. Also due to WMATA was a minimum guaranteed rent to be paid annually, starting with the fourth year and continuing through the initia[illegible] term. Additional rent to WMATA would be paid from the [illegible] through the fiftieth year based on a percentage of annual [illegible] income in excess of a base gross income of $9,500,000.

The key financial considerations of the proposal submitted by NGPA addressed each of the financial specifications required by WMATA in the prospectus. NGPA offered WMATA development period rent for the first three years of $250,000, $400,000, and $551,000 respectively. A minimum guaranteed rent of $1,007,000 was offered starting in the fourth year and continuing through the fiftieth year. The minimum rent was also made adjustable in the event that the finally approved development project provided for additional gross floor area beyond the minimum 432,000 gross

A5

100 mm

1.0 mm

ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

1.5 mm

ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

2.0 mm

ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz
1234567890

square feet allowed by Lot 44. In addition to guaranteed rent, NGPA offered WMATA participation in the gross profits of the project beyond the base sum of $9,500,000 annual gross income. In total, the financial returns to WMATA offered by NGPA were substantial when the minimum and additional land rent are considered together.

RESULTS

On May 15, 1983, the North Gallery Place Associates limited partnership was chosen as the developer of the Gallery Place North joint development site by the WMATA selection committee. WMATA's decision to award development rights to NGPA was based on a comprehensive evaluation of the proposal according to the following criteria:

- Financial Return to WMATA - NGPA's development proposal offered WMATA an adequate financial return on its landholding. In total, when the minimum rent and additional rents are taken together the financial return to WMATA was substantial.

- Joint Development Plan Feature - NGPA's joint development plan provided for a development program of architectural distinction consistent with the highest and best economic use of the site. Moreover, the proposed development program was consistent with WMATA and District of Columbia planning objectives for an enhanced Chinatown.

- DBE Plan Feature - With respect to DBE utilization NGPA's development proposal consistently met or exceeded WMATA's goals in every category of DBE participation. More specifically, NGPA proposed to utilize the services of minority-owned firms in almost every facet of the development program either individually or through joint venture.

- Developer Capability and Experience - NGPA was able to bring together a reputable development team. Where applicable NGPA integrated the services of expert consultants to provide professional support services to the development team.

As a result of being selected as the development entity for the Gallery Place North site NGPA entered into negotiations with Bergman for the rights to the adjacent properties. Final negotiations were successfully concluded at the time of this writing.

LESSONS LEARNED

Many lessons were learned by CDC and NGPA as a result of their participation in the joint development process. The most significant are:

1. Minority organizers and investors must recognize that, in many instances, certain pre-conditions must exist before a project can come together. Many of these pre-conditions have a basis in the local political environment. For example, in the case of Gallery Place North, the commitment of WMATA to DBE participation was an important pre-condition contributing to CDC's and NGPA's success. Where such commitment by a local transit agency does not exist a major investment of time and effort is required to bring it about. Also, it usually helps to have a responsive city government and business community. Again where it does not exist, it must be brought about through such efforts as participation in community organizations, business organizations, civic groups, professional associations, and volunteer organizations.

2. Even with local transit agency commitments for meaningful DBE equity participation in joint development opportunities, DBE project organizers must recognize that a great amount of time and money must be invested to plan and organize to participate in the process. Too often, DBE investors fail to appreciate the investment of time and money in getting an opportunity to the table. Without fair compensation and adequate incentives to competent minority professionals, they will be discouraged to bring projects of significance to the community. DBE investors must recognize that minority professionals, like other professionals have to make a living and pay their staff time and expenses. Since the money must come from somewhere, it is only fair that upfront "sweat equity" and expenses be fairly compensated.

3. The ownership structure of a deal is extremely important. While NGPA was organized as a limited partnership, CDC was organized as a corporation. This latter form of business organization is workable from a decision-making point of view only if most of the partners are experienced in real estate development transactions and financing. It is extremely risky to allow investors, irrespective of their sincerity, to decide on real estate development technical issues on which they know little about. From an investment point of view, it is more prudent for the DBE investor to leave the development decisions to a general partner who specializes in real estate development projects and have the DBE investor participate as a limited partner (no management responsibility and liability for decisions they lack expertise or resources to address). Otherwise, this is tantamount to having the patient advising

the surgeon where and how to cut during the operation. If DBE investors feel uncomfortable with their general partners, they shouldn't invest, or they should replace the general partners.

4. Risk capital is an essential ingredient to preparing a development proposal. Development proposals are expensive to produce ranging from $50,000 to $1,500,000 depending on the size and complexity of the project. It is absolutely important that the development entity have sufficient risk capital to cover expenses incurred in the preparation of a development proposal. If successful in obtaining the "development rights", the development entity must also have sufficient funds for all deposits and additional document preparation (i.e. complete architectural plans and marketing/financial feasibility studies, etc.) needed for applying for the construction loan and permanent financing. Notwithstanding the $437,500 of risk capital initially raised for this project, additional calls for monies were made from the general and limited partners after the "development rights" were obtained.

5. Assuming the availability of sufficient risk capital, there must be sufficient time given to prepare a development proposal for a joint development site. WMATA's solicitation on this project gave three months for the preparation of the proposal. It takes at least that much time to prepare a comprehensive marketing study. Therefore, make certain your development entity is given sufficient time to plan, organize and develop a competitive proposal. Six to nine months lead time for the preparation of a development proposal would be more reasonable.

6. Of all the documents developed for the development proposal, the most important are the financial pro formas and the partnership agreement. The latter must never be prepared hastily or by attorneys who do not specialize in real estate investment law. Your development entity will have to live with the good and the bad of this legal document. Your development entity is well advised to retain real estate development professionals with general partner and syndication experience to be able to assist you in carefully planning what must be in this legal document and have the agreement prepared by a specialist. Spend the money to do it right. Too much depends on the outcome.

7. All transit-related real estate development projects require extensive planning, attention to detail and coordination among public and private sector participants. This "real estate development process" is further complicated when a large number of community minority/women entrepreneurs must be organized to actively participate and invest in a project. An

absolutely essential element to this organizational effort is leadership. Because of the diversity of functions and roles within the process, this leadership is most effective when shared among the project organizers. As an example, in this particular project there were several leaders who played various roles at each stage of the project development:

Mr. Alfred H. Liu, A.I.A.

Mr. Liu was the project co-initiator, motivator, and the Architect of the project. It was his vision of what could be achieved by the Chinese community which enticed the community entrepreneurs to invest. Alfred is President of AEPA Architects Engineers, P.C., a Washington-based professional firm. He was also elected as the President of the Chinatown Development Corporation.

Dr. William Chin-Lee

Dr. Chin-Lee offered stability and balance to the project. Once motivated to participate, Dr. Chin-Lee kept the investment group moving forward with prudent compromises, leadership, and a sense of humor. His presence helped to unify the Chinese community. Dr. Chin-Lee serves as the Chairman of the Board of the Chinatown Development Corporation.

Dr. Dwan Tai

Dr. Tai, the project co-initator, challenged the thinking and approach of the partnership and CDC Board members. She planned and anticipated problems, and defined issues and tasks which needed to be addressed early to minimize loss and maximize gains. She suggested alternative approaches and provided industry information on lessons learned by other developers. Her attention to detail alerted the leadership to opportunities, threats, and challenges so that they could better evaluate their positions and responsibilities throughout the development process. Dr. Tai is President of the Capital Professional Center Inc. and the Tai Corporation headquartered in Washington, D.C.

These are only three of several leaders in the development group which provide insight into the diversity of leadership and personalities which must exist within an organizational effort of this type.

CONCLUSION

The primary objective of this case study was educational. The case study attempted to illustrate, by way of example, the prerequisite conditions, organizational factors, leadership and financial resources necessary to pursue the acquisition of the "development rights" for a joint development site. Although only a few key individuals were mentioned in the case study, Comprehensive Technologies International, Inc. (CTI), as the author, fully recognizes that many, many individuals played critical roles in the initial phases of this project. CTI regrets being unable to give due credit to everyone involved in the success of this project. Furthermore, CTI takes full responsibility for the educational presentation of this case study.

APPENDIX THREE

SOURCES OF COMMERCIAL REAL ESTATE MARKETING DATA AND STATISTICS

SOURCES OF COMMERCIAL REAL ESTATE MARKET DATA FOR REAL ESTATE INVESTORS

1. ANNUAL U.S. ECONOMIC DATA
FEDERAL RESERVE BANK OF ST. LOUIS
P.O. BOX 442
ST. LOUIS, MISSOURI 63166

2. BUSINESS IN BRIEF
ECONOMIC GROUP
THE CHASE MANHATTAN BANK, N.A.
NEW YORK, NEW YORK 100152

3. CENSUS OF POPULATION AND HOUSING
SUPERINTENDENT OF DOCUMENTS
U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON, D.C. 20402

4. CONSTRUCTION REVIEW
SUPERINTENDENT OF DOCUMENTS
U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON, D.C. 20402

5. CREDIT AND CAPITAL MARKETS
BANKERS TRUST COMPANY
P.O. BOX 318
CHURCH STREET STATION
NEW YORK, N.Y. 10015

6. DEVELOPMENT REVIEW AND OUTLOOK 1983-1984
ULI - THE URBAN LAND INSTITUTE
1090 VERMONT AVENUE, N.W.
WASHINGTON, D.C. 20005

7. DOLLARS & CENTS OF SHOPPING CENTERS: 1984
ULI - THE URBAN LAND INSTITUTE
1090 VERMONT AVENUE, N.W.
WASHINGTON, D.C. 20005

8. HOTEL/MOTEL DEVELOPMENT
ULI - THE URBAN LAND INSTITUTE
1090 VERMONT AVENUE, N.W.
WASHINGTON, D.C. 20005

9. HOUSING CHARACTERISTICS
SUPERINTENDENT OF DOCUMENTS
U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON, D C. 20402

10. HUD NEWSLETTER
SUPERINTENDENT OF DOCUMENTS
U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON, D.C. 20402

11. LIFE INSURANCE FACTBOOK
AMERICAN COUNCIL OF LIFE INSURANCE
1850 K STREET, N.W.
WASHINGTON, D.C. 20066

12. MORTGAGE BANKING
MORTGAGE BANKERS ASSOCIATION OF AMERICA
P.O. BOX 37236
WASHINGTON, D.C. 20013

13. MULTI-HOUSING NEWS
GRALLA PUBLICATIONS
1515 BROADWAY
NEW YORK, NEW YORK 10036

14. NATIONAL REAL ESTATE INVESTOR
COMMUNICATIONS CHANNELS, INC.
6285 BARRFIELD ROAD
ATLANTA, GEORGIA 30328

15. REAL ESTATE INVESTING NEWSLETT
H.B.J. NEWSLETTER
1 EAST FIRST STREET
DULUTH, MINNESOTA 55802

16. REAL ESTATE REPORT
REAL ESTATE RESEARCH CORPORATI
72 WEST ADAMS STREET
CHICAGO, ILLINOIS 60603

17. RENTAL HOUSING
ULI - THE URBAN LAND INSTITUTE
1090 VERMONT AVENUE, N.W.
WASHINGTON, D.C. 20005

18. SAVINGS AND LOAN SOURCEBOOK
U.S. SAVINGS AND LOAN
111 EAST WACKER DRIVE
CHICAGO, ILLINOIS 60601

19. SURVEY OF CURRENT BUSINESS
U.S. DEPARTMENT OF COMMERCE
WASHINGTON, D.C. 20402

20. THE MORTGAGE AND REAL ESTATE EXECUTIVE REPORT
WARREN, GORHAM AND LAMONT, INC
210 SOUTH STREET
BOSTON, MASSACHUSETTS 02111

APPENDIX FOUR

EXAMPLE OF LOCAL TRANSIT AGENCY PROSPECTUS

APPENDIX FOUR

NOTE OF EXPLANATION

Gallery Place of North Metro Site
Joint Development Prospectus
Washington, D.C.

INTRODUCTION

A major part of the joint development process is the selection of a development entity for a project. In many instances the selection starts with the issuance of a prospectus by a local transit agency. The following is a representative sample of a local transit agency joint development prospectus. It was selected to acquaint the interested DBEs with the various elements which go into the preparation of a joint development proposal.

A well prepared joint development prospectus is a valuable solicitation tool for a local transit agency. In many instances it is the sole description of the project for offering purposes. As a result, a typical joint development prospectus usually provides a carefully worded profile of development rights and requirements, rules of submission, criteria for selection and basic financial information. In addition, most local transit agencies also include drawings to show procedures for construction activities, easements, etc. for the developer's use in preparing preliminary designs and cost estimates.

gallery place
metro station

gallery place north metro site joint development prospectus

wmata parcel DF-013+
august 1982

office of planning and development
washington metropolitan area transit authority
600 fifth street, n.w. washington, d.c. 20001

gallery place north: metro site joint development prospectus

PROSPECTUS FOR JOINT DEVELOPMENT AT THE

GALLERY PLACE METRO STATION

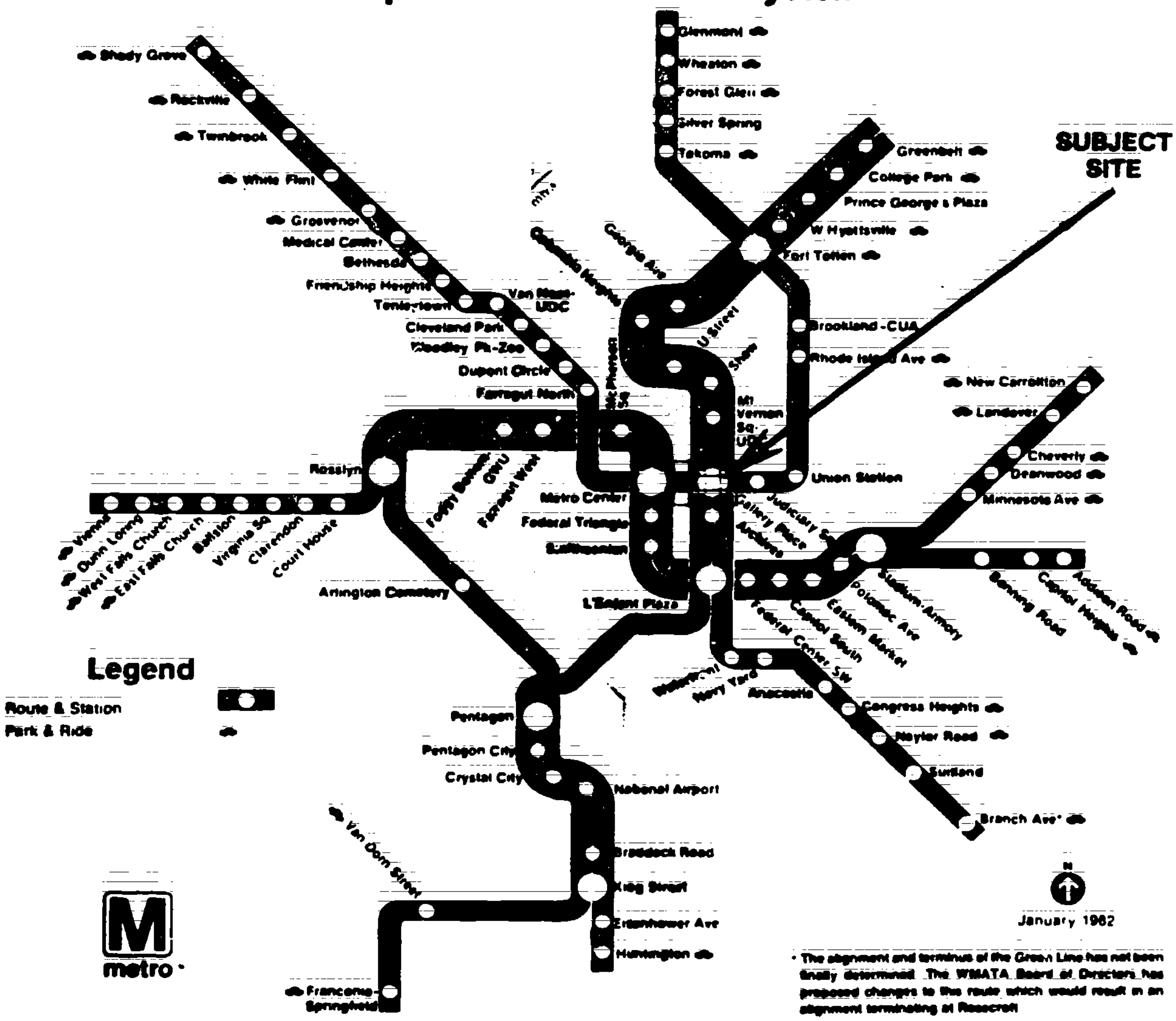
CONTENTS

APPENDICES

MAPS AND EXHIBITS

CONTENTS (continued)

Adopted 101-Mile Metro System



metro

Washington Metropolitan Area Transit Authority

600 Fifth Street, N.W., Washington, D.C. 20001

August 23, 1982

THE OFFERING

The Washington Metropolitan Area Transit Authority (WMATA) announces the availability for lease and development those incremental real property interests (interests exclusive of those required for transit purposes) contained in an approximate 50,895 square foot site at the Gallery Place Metrorail Station. Gallery Place is one of four transfer stations in the planned 101 mile Metrorail system with two tiers of station facilities at the intersection of the Red Line and the Yellow/Green Line. The upper tier station, on the Red Line, has been in operation since 1976. The lower tier station, on the Yellow/Green Line is presently scheduled for initial operations in late 1983.

WMATA's Gallery Place North Site is located in Washington, D.C. to the east of 7th Street, N.W. between G and H Streets, N.W. The site has frontage on each of these three streets and has direct access to a public alley connecting to G, H, and 6th Streets. The site was acquired by WMATA to construct and to operate the Metrorail system. Metrobus presently serves the site at 7th, G, and H Streets.

The purpose of this prospectus is to solicit proposals for the joint development of the site. All proposals must be submitted in the form and with those exhibits and with the deposit designated herein.

A feature of particular significance in this Offering is the opportunity for WMATA's selected developer to include the Bergmann's, Inc. property (described in Section I,B) along with the WMATA parcel to design and construct a larger, unified development. To this end, Bergmann's, Inc. has entered into an Option Agreement with WMATA, which WMATA will assign to its selected developer. The selected developer will be required by WMATA to negotiate with Bergmann's, in good faith, for the purchase of the Bergmann's property. (The Option Agreement follows as Appendix F).

Proposals must be received no later than December 8, 1982. As soon as practicable thereafter, WMATA will advise the interested parties as to the acceptability of their proposals. In the event you require further information or clarification, call or write the undersigned or John Green of this Office (202) 637-1593.

Sincerely yours,

Henry W. Cord / J.G.

Henry W. Cord, Head
Development Branch
Office of Planning & Development

PROSPECTUS

FOR

JOINT DEVELOPMENT

AT THE

GALLERY PLACE NORTH METRO STATION

The Washington Metropolitan Area Transit Authority (WMATA) requests proposals, pursuant to the terms and conditions hereinafter stated, for the development of approximately 50,895 square feet of real estate situated at WMATA's Gallery Place Metro Station, in Washington, DC.

All proposals must be submitted in the form and with those exhibits and deposits specified herein.

Proposals must be received by WMATA, Office of Planning and Development, 600 Fifth Street, N.W., Washington, D.C., 20001, no later than 1:00 p.m., December 8, 1982. Any questions or requests for clarification concerning this Prospectus must be submitted in writing no later than fifteen (15) days prior to the closing date to Mr. John Green at the above address. Mr. Green may also be reached by calling 637-1593.

A Pre-Proposal Conference will be conducted at 10:00 a.m. on September 15, 1982 at WMATA in the Lobby Level Meeting Room for the purpose of answering questions about the property and WMATA's joint development process. Attendees at this Pre-Proposal Conference will be considered "interested parties" eligible to receive written responses to inquiries or requests for clarification concerning this Prospectus.

I. Parcel Description

A. The subject WMATA property is located on the east side of Seventh Street, NW between G and H Streets, NW. It is identified as Square 454, Lot 44 and contains ±50,895 square feet. (A survey of the property is found under "Maps and Exhibits.")

d. The Bergmann's, Inc. property is also located within Square 454. (For the sake of convenience, the property is referred to as Parcels A, B, and C). Parcel A is adjacent to WMATA's Lot 44, and fronts on G Street, NW. It is comprised of Lots 806, 6, 859, 804, and 860. It contains ±23,569 square feet. Parcel B is to the north of Parcel A, across a public alley, and is also to the east of WMATA's Lot 44, across a public alley. It is comprised of Lots 37 and 852. It contains ±9,299 square feet. Parcel C is located along 6th Street, NW. It is comprised of Lots 862, 849, 848, 847, 846, 845, 844, 843, 38, 841, and 840. It contains ±19,705 square feet. The total area of Bergmann's Parcels A, B, and C is ±52,573 square feet.

II. Development Potential

This disposition of incremental land use rights at the Gallery Place Station Site in Square 454 involves a parcel of land known as Lot 44 containing 50,895 square feet, more or less, at the intersection of the Red (Shady Grove-Glenmont) Line, the Green (Greenbelt-Branch Avenue) Line, also congruent at this point with the Yellow Line (Greenbelt-Franconia/Springfield). The incremental land rights, those incremental to the rights required for construction, maintenance, and operation of the transit system, include surface rights, air rights, and sub-terranean rights inclusive of direct access to the Metrorail portal at the southeast corner of 7th and H Streets, N.W.

By mid-1984, the Metro system is expected to be operational on 61 miles and 60 stations. The joint development opportunity at Gallery Place involves the integration of transit facilities with a mixed-use development project. The joint development program objective is to promote a policy that yields these benefits: improved ridership, provision of revenue to WMATA, enhanced tax base, greater accessibility to the Metro facilities, and implementation of D.C. planning objectives.

The development potential at the Gallery Place North site is addressed further in Appendix E, Planning and Design Criteria.

III. Property Interest Offered

The property offered by WMATA for joint development under the existing C-4 zoning and Appendix E is a long-term leasehold estate. Fee simple interest to the Bergmann's parcels is available, subject to the developer's negotiation of a purchase agreement as provided for herein.

IV. Proposal Requirements

A. Joint Development Plan

Proposals must include a Joint Development Plan covering both WMATA's Lot 44 and the Bergmann's parcels.

The Joint Development Plan must include graphic and written descriptions of the proposed development consisting of preliminary plans and outline specifications prepared by a qualified architect. The plans and drawings must include a site plan, schematic floor plans, elevations and cross sections, residences (expressed in dwelling units), office space (expressed in gross floor area), hotel space (expressed in rooms and gross floor area), floor area ratios, and vehicular trips generated (PM peak hour), and projected Metrorail ridership generated by the development. These plans must reflect development of the site to its highest and best economic use and be responsive to those criteria and guidelines contained in Appendix E, reflect excellence in architectural design and site treatment appropriate to encourage maximum use of the Metro system and the related potential of the site, and provide functional and esthetic integration of Metro facilities. The Joint Development Plan should also include a schedule for project implementation including construction initiation, phasing, and completion. The schedule must recognize that the operation of the station will be uninterrupted and unimpeded during construction.

B. Minority Business Enterprise Plan

Proposals must include a Minority Business Enterprise (MBE) Plan. Desirable elements to be considered in preparation of an MBE Plan include minority participation in the following areas: equity participation, contracts for professional and technical services, construction contracting, purchasing of materials and supplies, building leasing and management. The minimum goals of MBE participation are contained in Appendix C herein.

Notwithstanding the MBE goals strived for by WMATA on a regional basis as set forth in Appendix C, WMATA and the District of Columbia are placing added emphasis on MBE participation for the Gallery Place North project given its location within both the City and Chinatown.

C. Statement of Qualifications

The proposal must include a Statement of Qualifications containing: the developer's corporate charter (certificate of incorporation and by-laws), partnership agreement or other organizational document; qualifications of the developer and each member of the development team and a record of past performance on similar projects demonstrating timely and successful completion. In addition, said qualifications must include a complete statement on the financial ability of the prospective developer to accomplish the planned development.

Illustrative material, including name and location, on previous projects of a similar character should accompany the proposal. The present status of each such project should be summarized and the names, addresses, and telephone numbers of local officials or other persons familiar with developments should be attached.

D. Financial Terms

Proposals must contain an offer to lease WMATA's Lot 44 said offer to be set forth on the proposal form provided herein (Appendix A).

Minimum Guaranteed Rent and Additional Rent shall also be required for the renewal term of the lease. Minimum Guaranteed Rent for the renewal term shall be determined by appraisal of the fair rental value of the land as if vacant and unimproved at its then current highest and best use. Additional Rent will be provided for the purpose of reflecting development intensity and real estate market conditions during the term of the lease.

All rental offers shall contain a pro forma analysis based on development of no more than 432,608 square feet of gross floor area. The pro forma analysis shall project the annual gross income and net cash flow for ten (10) years beginning upon initial occupancy of the contemplated improvements. Proposals must specify the year in which full occupancy is projected, and indicate the sublease rental schedules on which the pro forma analysis is based.

1. Lease - WMATA's Lot 44

   The lease, which shall not be made subject to subordination, shall be for an initial term of fifty (50) years with an option to renew for an additional term of forty-nine (49) years. There shall be a complete rental offer as follows:

   (a) Development Period Rental to be paid for the initial three (3) year development period of the lease. Rental may be on a fixed or a graduated basis but its total must be equivalent to a fair economic rental of the land for the development period.

   (b) Minimum Guaranteed Rent to be paid annually for the fourth (4th) year of the lease and each subsequent year of the initial lease term. All offers of Minimum Guaranteed Rent shall be based on a minimum development of 432,608 square feet of gross floor area. Minimum Guaranteed Rent will be adjusted upward in the event of a PUD or alley closing that provides for additional gross floor area.

(c) Additional Rent, over and above the Minimum Guaranteed Rent, to be paid for the fourth (4th) through the fiftieth (50th) year of the lease. Additional Rent must be offered as a specific percentage of all annual gross income[1/] from the commercial space of the project, without deduction, in excess of a base gross income of Nine Million Five Hundred Thousand Dollars ($9,500,000) per annum.

E. Additional Terms and Conditions

(1) Proposals shall be accompanied by a bid bond, certified check, or bank letter of credit acceptable to WMATA in the amount of $100,000 to guarantee that such proposal will not be withdrawn for a period of sixty (60) days from the proposal acceptance closing date. Said bid bond, letter of credit or certified check will be returned to all unsuccessful parties within ten (10) days thereafter.

(2) Within forty-five (45) calendar days after receiving written notice from WMATA to do so, the selected developer must execute necessary lease document furnished by WMATA. In the event the selected developer fails or refuses to do so within the said forty-five (45) day period, the developer's guarantee in the full amount of $100,000 shall inure to WMATA as and for liquidated damages.

1/ Gross income shall be defined as the cumulative amount of all monies received by the developer from operations on the leased property, including all monies received from sublessees or space lessees of the developer. Such amount shall include monies received by the developer from sublessees or space lessees as payment or reimbursement for the costs of operation, including without limitation, real estate taxes, insurance and utilities, or in the event that such costs of operation are paid directly by the sublessees or space lessees, an equivalent amount shall be included. Gross income shall also include all gross receipts from hotel operations, including but not limited to, all monies from room, food, beverage and any other income from hotel operations. Additionally, gross income includes the fair rental value of any used or occupied space by the developer within the leased property, except for that space reasonably necessary to operate the leased property and perform the obligations of the lease.

(3) In addition to inclusion of financial terms and the Joint Development Plan as herein specified, the lease document will incorporate at a minimum all provisions set forth in this Prospectus and Appendices.

V. Selection Procedure

A. WMATA will carefully analyze each proposal and ultimately select that proposal which in its sole judgment is deemed most advantageous to WMATA.

B. WMATA reserves the right, in its sole discretion, to make its selection based on the initial submission of those responding to this Prospectus, or to conduct negotiations should WMATA deem negotiations to be warranted or useful.

C. WMATA RESERVES THE RIGHT TO REJECT ANY OR ALL PROPOSALS.

D. WMATA expects to have completed its evaluation of all proposals and to have taken all necessary action to conclude its selection of a proposal within sixty (60) days following the closing date for receipt of proposals, including notification to the interested parties of the acceptance or non-acceptance of their proposals.

VI. Selection Criteria

It is the objective of WMATA that the development project to be awarded pursuant to this Prospectus result in the achievement of the goals of both WMATA and the District of Columbia. To accomplish this objective, the selection process will include review of proposals to ascertain conformance with the following guidelines:

A. Compliance with requirements set forth in this Prospectus.

B. Adequate financial return to WMATA.

C. Compliance with the criteria for development as contained in Appendix E.

D. Development of the land and air rights, as reflected by the Joint Development Plan submitted as part of the proposal, to the highest and best economic use in accordance with the criteria established in the Planning and Design Criteria, Appendix E.

E. Acceptability of the submitted Minority Business Enterprise Plan.

F. Reasonable probability that the propose development obtains for WMATA the income projected in the proposal.

G. Capability of the developers, based on financial qualifications and development experience, to undertake and complete the project within a reasonable and specified time period.

H. Completeness and clarity of preparation for ease of analysis.

Precise conformance to the detail specified in the Prospectus is not mandated at the risk of rejection for non-conformance. Where this Prospectus fails to envision innovation, so neither does it bar innovation when the innovation is in the best interest of WMATA.

Proposals not rejected following the above review will be evaluated, through a pre-established numerical weighted formula encompassing the following factors, listed in order of their relative importance:

- o Financial return to WMATA
- o Joint Development Plan features
- o Minority Business Enterprise Plan features
- o Developer capability and experience

Other than indicating relative importance of the listed factors, no conclusion should be drawn from the above listing as to the actual weight assigned each factor.

WMATA shall not be liable for any cost incurred by the selected developer prior to execution of the required lease documents.

APPENDIX A

PROPOSAL FORM

PROPOSAL FOR LEASE OF LAND AND AIR RIGHTS

TO: WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY

PROPOSAL OF: ______________________________
NAME

____
ADDRESS

____

Parcel A. Covering the lease of land and air rights for commercial development within WMATA's ±50,895 square feet at the Gallery Place North Site in Washington, DC, known as Lot 44, Square 454.

The undersigned hereby submits an offer to lease the commercial development rights at the subject property for a fixed term of fifty (50) years as follows:

A Minimum Guaranteed Rent for the fourth (4th) through the fiftieth (50th) lease year is offered in the amount of ______________ ($______________) per annum, payable quarterly in advance (to be adjusted upward in the event that the finally approved development provides for additional gross floor area).

Development Period Rent during the initial three (3) years of the lease term is offered as follows:

First lease year $____________,
Second lease year $____________,
Third lease year $____________.

Said amounts will be paid annually in advance to WMATA commencing upon lease execution.

In addition, for the fourth (4th) through fiftieth (50th) year of the lease term, I (We) offer Additional Rent consisting of

______ percent (__%) of all annual gross income from the project without deduction in excess of a base gross income of Nine Million Five Hundred Thousand ($9,500,000.00) per annum.

Construction for the proposed development shall commence on or before ________________, 19__, shall be completed on or before ________________, 19__.

1. The undersigned declares that a careful examination of the instructions contained in the Prospectus, dated ________________, 1982, has been made and understands that in making this proposal, all right to plead misunderstanding regarding the same has been waived.

2. This proposal is submitted directly and involves no real estate broker's commission to be paid by WMATA.

3. This proposal is accompanied by a proposal guarantee in the form of a bid bond, a certified check or a bank letter of credit in the amount of One Hundred Thousand Dollars ($100,000.00).

4. A Statement of Qualifications, Development Plans, a Statement of Gross and Net Income Expectancy and responses to all other Prospectus requirements in this proposal are contained as a part of this proposal.

5. Six copies of the full proposal are submitted herewith.

________________ DATE

________________ NAME

________________ SIGNATURE

________________ ADDRESS

Received this ______ day of ________________, 19 , by ________________, ________________, for the Washington Metropolitan Area Transit Authority.

APPENDIX B

ANTICIPATED MAJOR LEASE/PURCHASE TERMS AND CONDITIONS

SECTION I

GENERAL

A. In addition to the required lease rentals set forth in the Proposal Form, a cash sum of $200,000 shall be paid to WMATA upon execution of the lease document contemplated herein (the developer's original proposal guarantee deposit may be applied). Said sum will be held as a guarantee for performance by developer as required under this Prospectus, and upon satisfactory performance, said sum shall be applied to developer's rental payments for the fourth lease year.

B. Within six (6) months following execution of the lease agreement, the developer must have obtained approval from WMATA of its final plans. Any application for PUD must also be approved by WMATA.

C. The lease agreement, at the option of WMATA, may be terminated in the event that the developer fails to obtain WMATA's plan approval (B, above) within said six (6) month period, or fails to commence with development of the property within one (1) year from the date of WMATA's approval of the Development Plan. In the event of such termination, developer shall forfeit all lease payments through that date and the required performance guarantee. Time is of the essence in this proposed development.

D. Prior to commencement of construction, the developer shall deposit documents with, and acceptable to WMATA, indicating the availability of funds to complete the development project, and shall also deposit a copy of the selected contractor's performance bond, with surety companies satisfactory to WMATA, for the full amount of the contract price.

E. Lease rental payments during the initial three (3) year development period shall be payable annually in advance in the full amount specified

for each year in the proposal; the first such payment shall be due upon date of execution of the lease agreement. Rental payments commencing for the fourth (4th) lease year and each year thereafter shall be in the full amount of the Minimum Guaranteed Rent payable in equal quarterly installments in advance through the entire lease term. Commencing with the fourth (4th) lease year, developer shall also pay Additional Rent, as specified in the Prospectus, and such payment will be made on a lump sum basis within sixty (60) days following commencement of the fifth (5th) lease year and each lease year thereafter.

SECTION II

DESCRIPTION OF AREAS AND EASEMENTS TO BE RESERVED, RIGHTS TO BE RETAINED BY WMATA AND OBLIGATIONS OF DEVELOPER

A. PERMANENT EASEMENT AREAS TO BE RESERVED:

WMATA will retain multi-dimensional easement areas (illustrated on the Gallery Place Easement Map) described as follows: (a) a portion of the western border of the site, a 4.36 foot wide easement with an upper limit of +14.31 feet (approximately 30 feet below grade); (b) a portion of the western and southern borders of the site, a 5 foot wide easement with an upper limit of +41.5 feet (approximately 5 feet below grade); (c) a sewer easement at the southwestern portion of the site; and (d) an easement at the north entrance of the Gallery Place Metro Station, the limits of which are (1) an approximately 30 foot apron east of the entrance measured from the escalator newel, (2) a 15 foot strip along the southern edge of the escalator, and (3) a one-story (minimum 12 foot, six inches) clear height above grade.

B. PERMANENT AND EXCLUSIVE EASEMENTS, RIGHTS AND RIGHTS-OF-WAY, UPON, OVER, UNDER AND ACROSS THE PERMANENT EASEMENT AREAS:

a. Rights within the areas required for Metro purposes for design, construction, maintenance, operation, repair, replacement,

renewal or removal of structures, equipment, installations and facilities necessary or useful for Metro rapid transit purposes and uses incidental thereto.

b. Rights of access to and from said areas at any time for the above-stated purposes by WMATA, its employees, agents and contractors; in addition, during operation of the rapid transit system, rights of access by the general public through said areas in connection with use of said system.

c. Rights of vertical and horizontal support and protection of WMATA's structures, installations, equipment and facilities, including necessary installations such as foundations, beams, columns, bracing, and similar structural features and members. No load or pressure, whether vertical or lateral, shall be transmitted to any part of said Metro facilities, except as may be provided for hereunder.

d. Rights to make, maintain, operate, replace and renew necessary utility installations, including wires, cables, pipes, ducts, chases, conduits, and all equipment and apparatus of any type whatsoever necessary to operate the Metro Station entrance and related facilities.

e. Rights as to the unimpaired, unrestricted use and enjoyment of the station entrance facility and the described premises free from and without the adverse or detrimental effects of such use of adjacent areas, which might result in or from (1) such concentration of people in the access area as would obstruct access to and from the station facility; (2) loud, sustained or unpleasant noises; (3) noxious odors; (4) accumulation of trash, dirt or debris; (5) harsh lighting and/or lighting fixtures or signs,

posters or billboards not compatible with Metro graphics requirements. Any Lessee graphics with exposure to the Metro facilities shall be subject to WMATA's prior approval.

f. Rights permitting the erection and installation of walls, ceilings, partitions, signs, structures, facilities and equipment in the described premises and rights to maintain, repair, operate, replace or remove the same. This right includes rights of attachment of WMATA's ceiling structures, electrical equipment for lighting and other necessary utilities to the underside of the floor constructed above the Metro entrance facility. Lessee shall initially install ceiling structures and electrical equipment to WMATA's satisfaction and thereafter said facilities will be maintained by WMATA.

g. Rights for such other and different purposes as WMATA, its successors and assigns, may from time to time hereafter deem necessary or advantageous in connection with its use of the rapid transit station facilities and uses incidental thereto.

Further, information and data furnished to the Lessee, including available subsurface and other data, are not intended as representations or warranties but are furnished for information only. It must be understood that WMATA will not be responsible for the accuracy thereof or for any deductions, interpretations or conclusions drawn therefrom. Such data will be made available to allow Lessee to have the same information that is available to WMATA. Developer will hold WMATA harmless from and against all claims or demands with respect to such information and data.

C. <u>Obligations of Developer</u>

Development and subsequent use of the private development facilities must never interfere with or adversely affect WMATA's facilities, including

the need for repair, replacement, removal or operation of the Metro station, mezzanine, and related facilities, unless prior arrangements have been made in writing between WMATA and the developer.

The overall Joint Development Plan proposal must provide adequate facilities for the free flow of Metro patrons and include suitable facilities for and accessibility by the non-ambulatory handicapped, to and from the Metro facilities.

Electric power for ceiling and surface lighting shall use existing circuits as far as possible. Additional requirements above the capacity of Metro circuits shall be metered separately.

Failure to provide the facilities as set forth above will result in the forfeiture by the developer of the deposit in the amount of $200,000 as specified in the Prospectus, all lease agreement payments to that date and, at WMATA's option, cancellation of the lease agreement between the parties.

SECTION III

COVENANTS AND RESTRICTIONS

A. WMATA Construction

All property of any kind and howsoever described by WMATA and/or its contractors upon, over, under, in or on the premises within the limits of the interests in the estate to be reserved by WMATA shall remain the property of WMATA and/or its contractors and may be removed therefrom by WMATA and/or its contractors at any time.

B. Developer's Construction

The developer shall have the right to construct, maintain, repair, replace, or renew its improvements on the property provided: (a) that the method, schedule, plans and specifications are submitted to WMATA for approval at least 60 days prior to the commencement of any construction, maintenance, repair, replacement or renewal of any improvements; (b) that the construction,

maintenance, repair, replacement or renewal does not change or affect the Metro facilities or <u>any</u> access thereto except as may be required by the laws, ordinances, codes or regulations of the District of Columbia and is agreed to by WMATA. WMATA's approval of the method, schedule, plans and specifications will not be arbitrarily or unreasonably withheld and WMATA accepts no liability or waives no rights by reason of its approval of the method, schedule, plans and specifications. At the time WMATA issues its approval of the construction, maintenance, repair, replacement or renewal, WMATA shall designate an employee or representative in writing to perform the inspections provided for below; and (c) that the construction plans shall incorporate all facilities necessary for the temporary protection of the public and WMATA facilities during construction.

Developer also covenants and agrees that it shall permit the authorized employees and representatives of WMATA to enter the property at any time during the course of the construction, maintenance, repair, replacement or renewal of improvements and that WMATA's designated employees or representatives shall have the authority to stop the construction, maintenance, repair, replacement or renewal whenever they determine that such stoppage shall be necessary to insure the functioning and safety of Metro or any facility related thereto and the safety of the users of Metro, employees, and the agents, licensees, and permittees of WMATA. In the event of any stoppage of the construction, maintenance, repair, replacement or renewal which is contested by the developer, there shall be immediately appointed by the developer and the designated representative of WMATA a mutually acceptable neutral firm or person to ascertain if such stoppage is reasonable within the meaning of this section and further the decision of such third person or firm shall be binding upon the parties and be made within 24 hours of the stoppage.

WMATA, its employees and authorized agents shall have the express right to enter the building structures or improvements of developer to inspect all

equipment, materials, facilities and said structures, improvements, and building at reasonable times to insure compliance with the restrictions and conditions set forth.

C. Insurance by Developer

During construction and following completion of construction of buildings, structures and improvements by the developer, the developer covenants that it will insure all buildings, structures and improvements erected on the herein described property. Such insurance shall protect both the developer and WMATA from loss within the developer's structure and shall protect the developer against loss from any fire or other damage originating in the facilities of WMATA. Such insurance shall be in the amount which will allow the repair, replacement or removal of any structure which is so damaged. Developer further agrees that from time to time WMATA or its representative may, upon reasonable notice, examine the fire insurance policies carried by the developer. Developer further covenants and agrees that it will not allow any structure, improvement or building to remain damaged so that it interferes with the use of Metro, the Metro station, or any related facility during the construction by the developer of any facility and during the use by the developer, any sublessee, assignee, contractor, licensee or other agent or employee of the developer. The developer further agrees to maintain public liability insurance in which WMATA shall be named as an additional insured containing provisions adequate to protect both the developer and WMATA from all liability for death or injury to persons or damge to property.

D. Taxes and Assessments

The developer covenants and agrees to make timely payment of all real estate taxes and assessments which may be levied, assessed or charged against the property and that WMATA shall have no responsibility for any taxes, assessments or charges on the property.

E. Compliance with Zoning and Ordinances

The developer agrees that the buildings and improvements to be erected and all uses thereof, shall comply with the zoning and building codes and the laws, extensions and ordinances of the District of Columbia and it shall be the responsibility of the developer to obtain any building permits and/or approvals as may be required.

F. Indemnification

The developer agrees to indemnify, protect, defend and save WMATA, its agents and employees, harmless against any and all loss, damage, claim or liability whatsoever due to personal injury or death, or damage to the property of others directly or indirectly due to the use of the property and caused by the negligence of the developer, its agents, employees, contractors, permittees, invitees and licensees. Developer will be required to hold WMATA harmless from all claims arising from noise, vibration or otherwise from WMATA's Metro operations.

G. Affirmative Action

Developer agrees to provide that all qualified parties regardless of race, religion, national origin and sex have an equal opportunity to participate in the construction, development, leasing, sale and management of this project. This includes compliance with the "Washington Plan" during construction of the improvements. Developer shall comply with an approved Minority Business Enterprise (MBE) Plan, which shall be in the form contained herein (Appendix C).

H. Priority for Displaced Occupants

Developer assures compliance with WMATA policy adopted May 14, 1970, entitled "Preferential Treatment of Displaced Occupants." The approved resolution covering this policy is contained hereinafter as Appendix D and made a part hereof.

APPENDIX C

MINORITY BUSINESS ENTERPRISE (MBE) PLAN

I. NOTICE OF REQUIREMENT

A. Lessee's overall minimum goal for minority participation in this project through equity participation or by subcontracting or joint venture with minority business enterprises ("minority" being Black, Hispanic, Asian, and Pacific Islander, and American Indian or Alaskan Native) in conformity with the Requirements, Terms and Conditions of this Exhibit hereinafter set forth shall be as follows:

1. Twelve (12) percent participation by minority investors in the equity ownership of the development project, and
2. Twenty (20) percent Minority Business Enterprise (MBE) participation during the development period will be sought in the following categories, without limitation (1) construction of the building (as prime or sub-contractor); (2) non-construction services; (3) professional services; (4) building management; and (5) supplies and services, and
3. Ten (10) percent goal for the initial leasing of retail rental space to MBE's which goal shall continue for five (5) years from the date of full occupancy, and
4. Twenty (20) percent goal during the entire term of the lease for MBE participation in the management and operation of the building, inclusive of all purchases, supplies, building services, including janitorial services.

B. Lessee shall have provided a projected plan for minority participation and utilization in the above-described areas in the submittal of their development proposal, and said projected Minority Participation Plan shall

have been approved by Lessor prior to the execution of the lease agreement within which this Exhibit shall be incorporated.

II. REQUIREMENTS, TERMS AND CONDITIONS OF AFFIRMATIVE ACTION PLAN:

A. Minority business enterprise, for the purpose of this Exhibit, means any sole proprietorship, partnership, joint venture, or corporation which is at least fifty-one (51) percent owned by minority groups members, and as to which such members exercise fifty-one (51) percent or more effective control over the management process. The amount of MBE participation will be determined by the dollar value of the work performed and/or supplies furnished by qualified firms as compared to the total value of all work performed and/or supplies furnished under this lease.

To be considered qualified, a MBE firm must have adequate financial resources or the ability to obtain such resources as required during performance of the contract, the ability to perform the work or furnish the supplies in a timely manner, and have minority members of the firm who have either financial, managerial or technical skills in the particular area of interest.

B. Lessee shall submit Attachments 1, 2, 3, 4, 5, and 6 as required by Authority policy as a prerequisite to actual construction on the leased premises.

C. The MBE goal established by this Exhibit shall express the Lessee's commitment to the percentage of MBE utilization. Lessee shall be deemed to have met its commitment if the MBE utilization rate of the Lessee meets or exceeds the goal established by this Exhibit.

D. Lessee's commitment to the specific goal is to meet MBE objectives and is not intended and shall not be used to discriminate against any qualified company or group of companies.

E. Lessee shall have a continuing obligation to maintain a schedule for participation by MBE(s) to meet its goal set forth in this Exhibit. If at any time Lessee believes or has reason to believe that a proposed MBE has become unavailable or due to change in ownership or management responsibility does not meet the standards set forth in paragraph 1 above, Lessee shall, within ten (10) days, notify Lessor of that fact in writing. Within ten (10) days thereafter, Lessee shall, if necessary to achieve the stated goal, make every reasonable effort to sub-contract the same or other work to other MBE firms. Lessee's efforts to replace an unavailable MBE firm shall be coordinated with Lessor.

F. Lessee's commitment to the specific goal for MBE utilization as required by this Exhibit shall constitute a commitment to make every good faith effort to meet such goal by sub-contracting and/or joint venture with MBE firms. If Lessee fails to meet its goal, it will bear the burden of furnishing sufficient documentation of its good faith efforts to justify grant of relief from the goal set forth in this Exhibit. These efforts shall include the following:

1. Notification of community organizations that Lessee has sub-contractor opportunities available and maintenance of records of the organizations' responses.
2. Maintenance of a file of the names and addresses of each MBE sub-contractor referred to it and action taken with respect to each such referred contractor.
3. Dissemination of its MBE policy externally by informing and discussing it with all management and technical assistance sources; by advertising in news media, specifically including minority news media; and by notifying and discussing it with all sub-contractors and suppliers.

4. Engagement in specific and constant personal (both written and oral) recruitment efforts directed at MBE contractor organizations, recruitment organizations, and business assistance organizations.

G. Lessee will keep records and documents for five (5) years following the performance of all activities and transactions during the term of the lease to indicate compliance with this Exhibit. These records and documents, or copies thereof, will be made available at reasonable times and places for inspection by any authorized representative of Lessor and will be submitted upon request together with any other compliance information which such representative may require.

H. Lessee is bound by all the requirements, terms and conditions of this Exhibit.

I. Lessee shall be required to submit to Lessor monthly statements during the development and construction phases which reflect all funds disbursed to minority sub-contractors and vendors, the type of work performed, total sub-contract amount, percentage of physical work completed, and cumulative payments to date. Where Lessor finds that Lessee has failed to demonstrate a good faith effort to comply with the requirements of this Exhibit, it will notify Lessee of such noncompliance and the corrective action to be taken. Lessee shall, after receipt of such notice, immediately take corrective action. Where Lessee, after notice and hearing afforded it by Lessor is found to have failed to exert a good faith effort to involve MBE's in the work as herein provided, Lessor may declare that Lessee is ineligible to receive further WMATA contracts for a period of five years from the date of the finding.

J. Attachments to be submitted as a prerequisite to actual construction on the leased premises are:

Attachment 1: Schedule of MBE Participation

Attachment 2: Letter of Intent to Perform as a Sub-Contractor

Attachment 3: MBE Unavailability Certification

Attachment 4: Information to Assist in Determining Legitimacy of MBE

Attachment 5: Information to Assist in Determining Legitimacy of Joint Venture

Attachment 6: Affidavit of Minority Business Enterprise

Copies of the above six attachments are available at WMATA, Office of Planning and Development.

APPENDIX D

POLICY FOR DISPLACED OCCUPANTS

OF THE

WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY

(Resolution of WMATA Board of Directors)

WHEREAS, the responsibility of the WMATA to design, construct and cause to be operated a regional rail transit system will involve extensive land acquisition and the concomitant displacement of persons; and

WHEREAS, the Washington Metropolitan Area Transit Authority Compact provides for a program of resettlement services to individuals, families, business concerns and non-profit organizations displaced from their homes and places of business by the construction of the rapid transit system; and

WHEREAS, the WMATA policies and procedures governing the resettlement of individuals, families, business concerns and non-profit organizations are set forth in the Office of Real Estate Policies and Procedures Manual; and

WHEREAS, it is the intent of the Board of Directors of the Washington Metropolitan Area Transit Authority to lessen to the extent possible the hardship encountered by displaced individuals, families, business concerns and non-profit organizations in finding resettlement sites;

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF THE WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY, that the policies and procedures governing the resettlement of persons and the disposal of real property as presently set forth in the Office of Real Estate Policies and Procedures Manual be revised to include the following policy guides:

(a) Individuals, families, business concerns and non-profit organizations displaced by WMATA shall be given a priority of opportunity

to relocate in commercial or residential facilities subsequently constructed on WMATA properties.

(b) This priority of opportunity will extend to former occupants of required properties and not to the owners of the properties unless the properties were occupied by the owners at the time of WMATA's acquisition.

(c) The priority of opportunity will be afforded to occupants displaced from real property by WMATA on or after March 29, 1968.

(d) The priority of opportunity will be made available by WMATA in its agreement with developers by requiring that the developers give a preference to the displaced occupants for the first 60 days following execution of the development agreement; provided that the displaced occupants otherwise qualify (in terms of financial qualifications, and other standards of occupancy established by the developer) for such lease or sale of the new facility; and provided further that the developer shall have the right to determine which commercial or residential uses are to be permitted in the facility and the size of each unit, and that in the event two or more persons entitled to preference apply for lease or purchase of the same space, the developer in his sole discretion may determine which is entitled to preference over the other or others.

(e) WMATA will certify displaced occupants to developers only in conjunction with the initial leasing or sale of newly constructed facilities.

(f) Further policies with respect to the above priority of opportunity may be established by the WMATA from time to time in conjunction with the establishment of procedures for the disposition of individual parcels.

APPENDIX E

PLANNING AND DESIGN CRITERIA

It is noted that creativity and excellence in urban design is not only strongly encouraged, but will also be afforded significant weight in evaluating proposals. The basic guidelines in this Appendix are intended to provide a general framework to proposers of urban planning and design criteria. However, the guidelines are not intended to preclude other considerations of merit which proposers may wish to address in the proposals.

a) Zoning: The subject site, Square 454, Lot 44, is within the C-4 zoning district (Central Business District). The C-4 district serves as the compact core of high density retail, office, hotel, residential, and mixed-use development in the District of Columbia and the Metropolitan area.

b) Floor Area Ratio (FAR): The C-4 district permits a maximum FAR of 10.0 if located adjacent to a street of 110 feet or more in width. Otherwise, the maximum FAR is 8.5. The subject site (50,895 square feet) would yield a maximum FAR of 8.5, resulting in 432,607 gross square feet.

c) Height Regulations: The building erected on the subject site would be limited to 110 feet in height with no limit in number of stories.

d) Planned Unit Development (PUD): Section 7501 of the District of Columbia's Zoning Ordinance contains provisions for PUD's in the C-4 zoning district. Use of the PUD provisions may yield a FAR of 10.5 on the subject site, 2.0 additional FAR than could be achieved above the matter-of-right zoning in the C-4 zoning district. The PUD process involves review and approval by the D.C. Zoning Commission. Proposers are encouraged to consider the PUD option.

e) Metro Facilities: The site will feature direct access to Metrorail station facilities. Gallery Place is one of four station areas in the planned eighty-two station area system which is a transfer station between intersecting lines. Moreover, Square 454 is currently well-served by Metrobus, with stops on 7th, 6th, G, and H Streets. Accordingly, the uses, design, and pedestrian system must not only complement, but enhance transit ridership.

f) Parking: While on-site parking space requirements do not exist in the C-4 district for mixed-use development, some on-site parking will have to be provided. (One potential site is the Bergmann's Parcel C along 6th Street.) Consideration should be given to multi-user parking during off-peak periods, e.g., provision of parking for restaurant and entertainment patrons during mid-day, evening, and weekend periods.

g) Mixed Use: The subject site is located in an area proposed for a mixture of land uses. Proposers will be required to develop a project which includes a mixture of uses. The first floor shall be developed primarily to retail use including stores, shops, restaurants, etc. The mixture of retail should be diverse, with a number of stores oriented to the street frontages rather than interior or mall areas. Also, below grade retail space is required at the H Street Metro connection.

The unified development, involving WMATA's and Bergmann's properties, in addition to the retail, must be comprised of either hotel and residential or hotel, commercial office and residential; with a goal of twenty-five percent of the developable land devoted to residential.

Any commercial use shall incorporate office space that would serve the needs of small professional firms or businesses serving the Chinese community and the retail space shall incorporate space to serve the needs of the Chinese community.

Proposers are encouraged to provide theater, cinema, entertainment, or arts spaces in their projects. Inclusion of these uses would further help to establish support for possible PUD applications.

In addition to the below grade H Street Metro connection, the subject site also presents the opportunity for a below grade Metro connection at G Street. Proposers are encouraged to provide additional retail space at this location.

(If subsequently WMATA of necessity proceeded with development of its parcel alone, then the acceptable mixes on the WMATA site would be either retail and hotel or retail, commercial office, and residential.)

h) Adjacent Parcels: Proposals of a unified development in Square 454 are required. The second major landowner in the western half of the Square (to the west of the public alley connecting G and H Streets) is Bergmann's Inc. Proposals must include plans for the development of the Bergmann's site in conjunction with Lot 44. The developer selected by WMATA will be assigned an exclusive option to purchase the Bergmann's site, and said option, as evidenced by execution of a Purchase Agreement between Bergmann's and the selected developer, must be pursued in good faith by the developer and exercised within ninety (90) days of the date of WMATA's selection notification to the developer. In the event Bergmann's and the developer, both acting in good faith, are unable to execute a Purchase Agreement

within said ninety (90) day period, WMATA at its sole discretion, may then proceed with the developer for the development of Lot 44 apart from Bergmann's parcels.

Additionally, there are four structures along H Street west of the alley in private ownership. Representatives of these parcels should be contacted to determine their possible interest in a unified development. While plans should indicate these parcels and possible use or re-use, there is no requirement in this Prospectus that these parcels be brought within the scope of the proposals.

The District of Columbia Government has indicated that it will be more likely to be favorably disposed if a unified development of the subject site and the Bergmann's property is proposed when consideration is given for a PUD or an alley closing.

If development of the western half of Square 454 in a unified fashion is not feasible, at a minimum a common plan or meaningful coordination must occur among the parcels.

i) Relationship to Chinatown: The design of the development on the subject site should reflect the character of an enhanced Chinatown. The development must recognize the importance of H Street as the "main street" of Chinatown, and the corner of Seventh and H Streets as a "gateway" for the community; proposers should consider the suitability of design with a Chinese character at these locations, although the entire development need not be of an overt Chinese character.

The Chinese community has identified several needed services which would be appropriate for the site: bilingual professional

services, retail use, performance and assembly space, and community services.

j) Scale and Design: The massing of the development should respect the variety of scale of the surrounding area. This is specifically meant to discourage monolithic structures.

The Seventh Street frontage should be conceived with a horizontal and vertical variety of scale. This design concept will encourage the building to better integrate with, and be more sensitive to, the landmark buildings on the west side of Seventh Street.

k) Public Space: Sidewalk treatment, tree spacing, lighting, and placement of street furniture shall be in accordance with the streetscape plan currently under preparation by the D.C. Government. The developer shall also comply with more detailed streetscape standards anticipated as part of the special Chinatown area criteria, which will result from the Downtown Planning effort.

Development at-grade shall have a frequency of retail entrances focused on the street so that the structure respects the established pattern and character along Seventh Street.

Retail uses should be of a type which generates activity for extended hours of operation beyond the normal workday.

If a unified development is proposed for Square 454, which includes other than just the WMATA parcel, the entire development proposal shall respect the Planning and Design Criteria outlined for the WMATA property.

l) Access and Orientation: Vehicular and service access is discouraged from 7th and H Streets and shall be reviewed and require

approval by the D.C. Department of Transportation. (Bergmann's 6th Street parcel is a potential site for vehicular access). Pedestrian orientation shall be toward the street. An interior circulation pattern can only be considered if it is an extension of the public space and not an alternative to it.

Subgrade connectors from the proposed development to the Metro station is required at H Street. There is further opportunity for a connection on G Street. An extensive underground pedestrian network with retail frontage, however, is not encouraged if such a system would be detrimental to at-grade retail activity.

m) Other Major Development: The subject site's development shall be both harmonious to and complementary to other major development, planned or underway, in the area. Recognition and relationship in function shall therefore be demonstrated, e.g., with the Convention Center and the mixed-use development of Square 455 (to the south of Square 454).

Proposers are referred to applicable publications relating to urban design guidelines for Square 454, e.g. "A Living Downtown for Washington, D.C." and the interim streetscape guidelines. Both documents are available from the D Office of Planning and Development.

OPTION AGREEMENT

THIS OPTION, granted the 16 day of July, 1982, by BERGMANN'S, INC., a Delaware corporation, 623 G Street, N.W., Washington, D.C. 20001 (hereinafter referred to as the "Optionor"), to WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY, a public transportation partnership of the District of Columbia, Maryland and Virginia, 600 Fifth Street, N.W., Washington, D.C. 20001 (hereinafter referred to as the "Optionee").

1. Grant of Option. In consideration of the premises, the sum of One Dollars ($1.00) and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Optionor hereby grants to the Optionee the exclusive option to purchase certain real property situated in the District of Columbia together with the improvements erected thereon, and more fully described as Lots 6, 37, 38, 804, 806, 840, 841, 843, 844, 845, 846, 847, 848, 849, 852, 859, 860, and 862, in Square 454, as outlined in red on Exhibit "A" attached hereto and incorporated herein by reference (hereinafter referred to as "the property").

2. Expiration Date. This option shall expire at 5:00 P.M. on May 13, 1983, or ninety (90) days after Optionee "selects" its developer for the Gallery Place Station, whichever shall first occur.

3. Exercise of Option. This option is to be exercised by the Optionee by the execution of a purchase agreement acceptable to the Optionor. This purchase agreement must be signed by an authorized representative of the Optionee, and mailed, certified or registered mail, return receipt requested, and received by Optionor prior to the time of the expiration of this option as set forth in paragraph 2. above, to Optionor, c/o Richard Bergmann, President, at the address set forth above, with a copy to George A. Brugger, Esquire, Fossett & Brugger, 10210 Greenbelt Road, Seabrook, Maryland 20706.

4. Failure to Exercise Option. If the Optionee does not properly exercise this option as herein provided, the option shall expire as set forth herein, and neither party shall have any further rights or claims against the other.

5. Assignment. This option and all rights hereunder shall be freely assignable by the Optionee to the developer which it has selected at the Gallery Place Station, and if assigned by the Optionee, any and all rights and obligations of the Optionee hereunder shall become the rights and obligations of the Assignee. Concurrent with such assignment, the Optionee shall notify the Optionor of such assignment by sending to the Optionor a copy of such assignment, c/o Richard Bergmann, at the address set forth above, with a copy to George A. Brugger, Esquire, at the address set forth in paragraph 3. above.

6. Headings. The captions and headings herein are for convenience and reference only and in no way define or limit the scope or content of this Option Agreement or in any way effect its provisions.

IN WITNESS WHEREOF, the parties hereto have executed this Option Agreement for the purposes set forth herein.

ATTEST:

BERGMANN'S, INC.

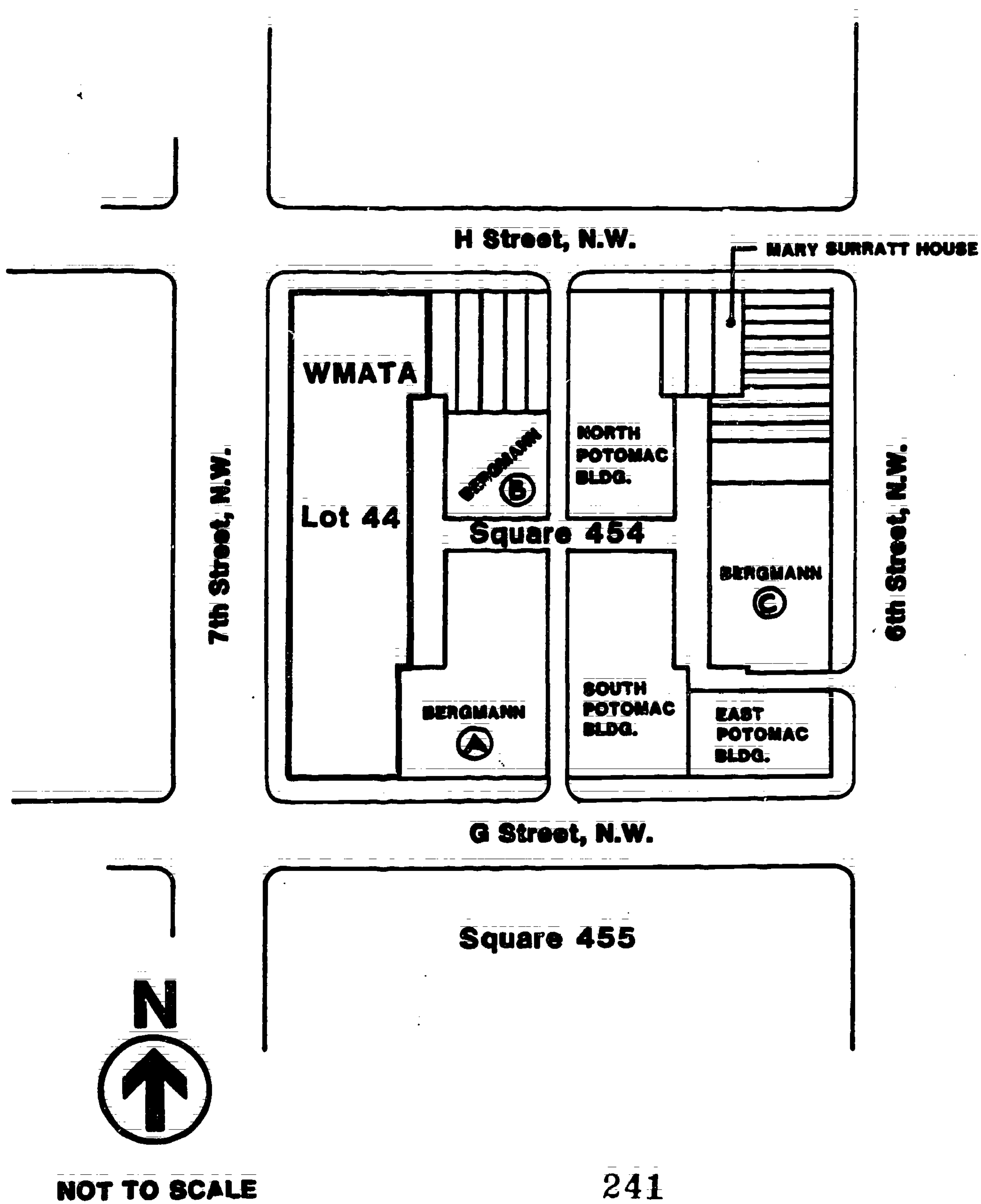
By: Richard W Bergmann President

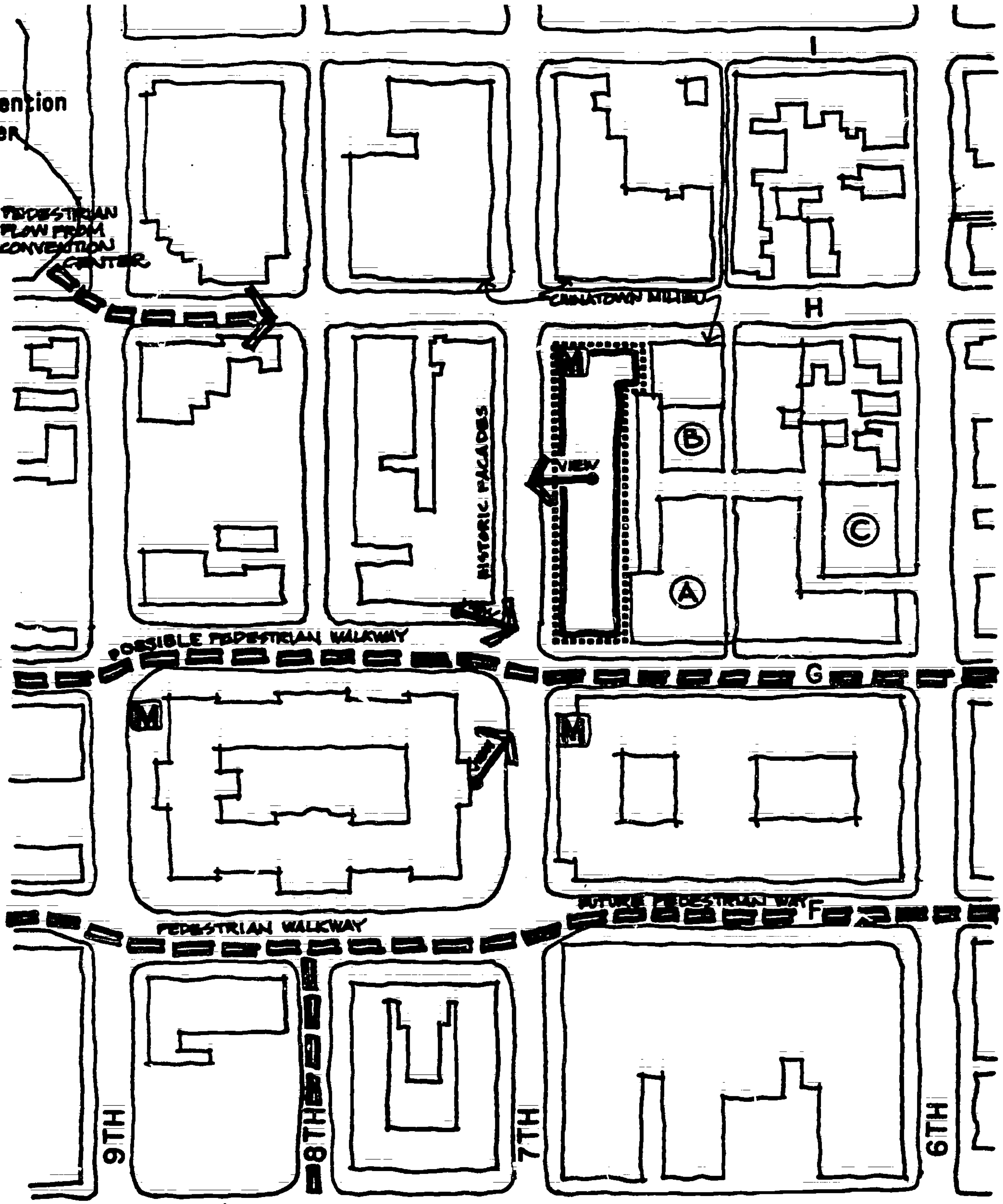
WITNESS:

WASHINGTON METROPOLITAN AREA
TRANSIT AUTHORITY

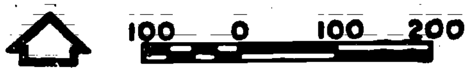
By:

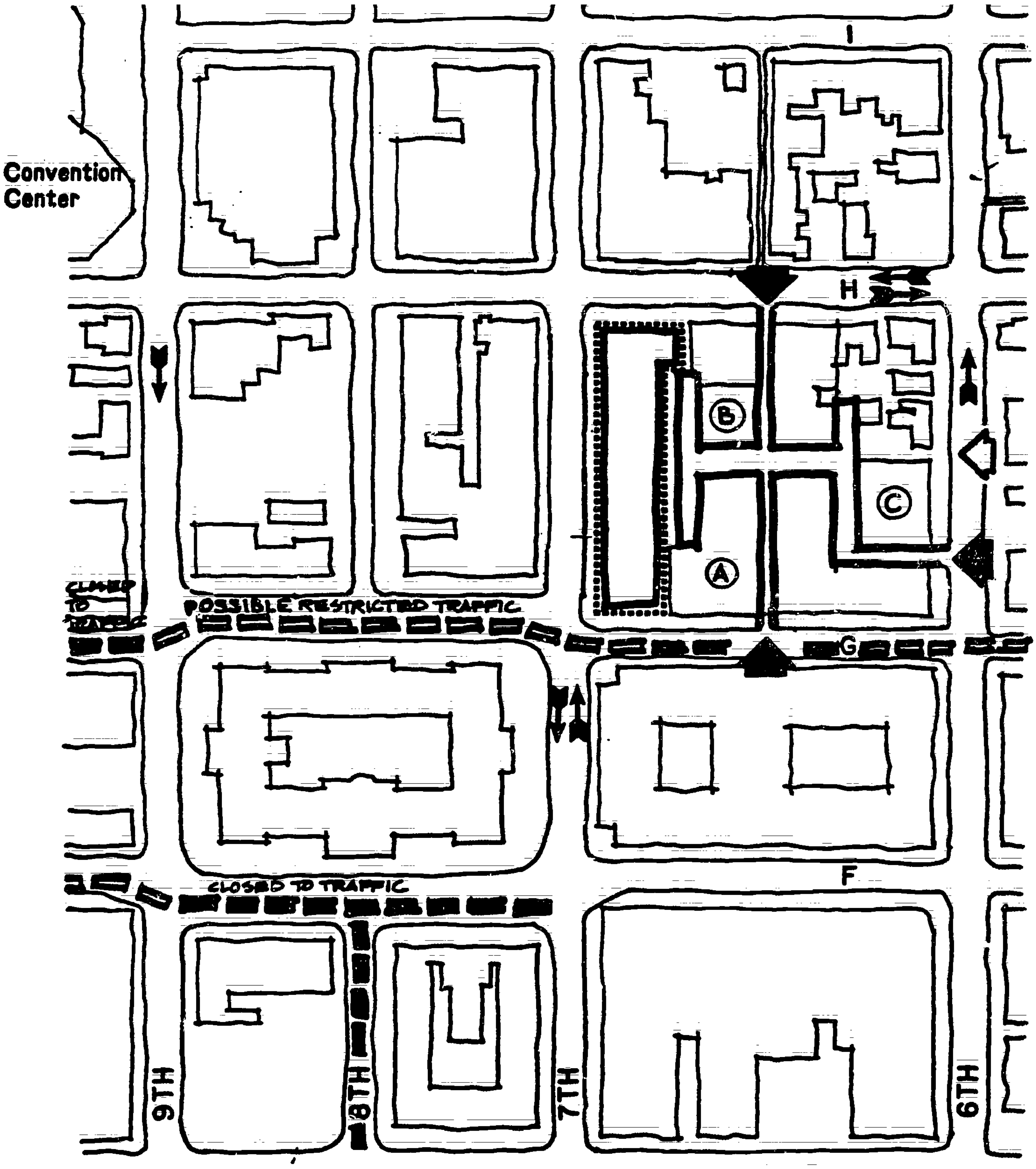
GALLERY PLACE VICINITY PLAN





GALLERY PLACE
Site Characteristics



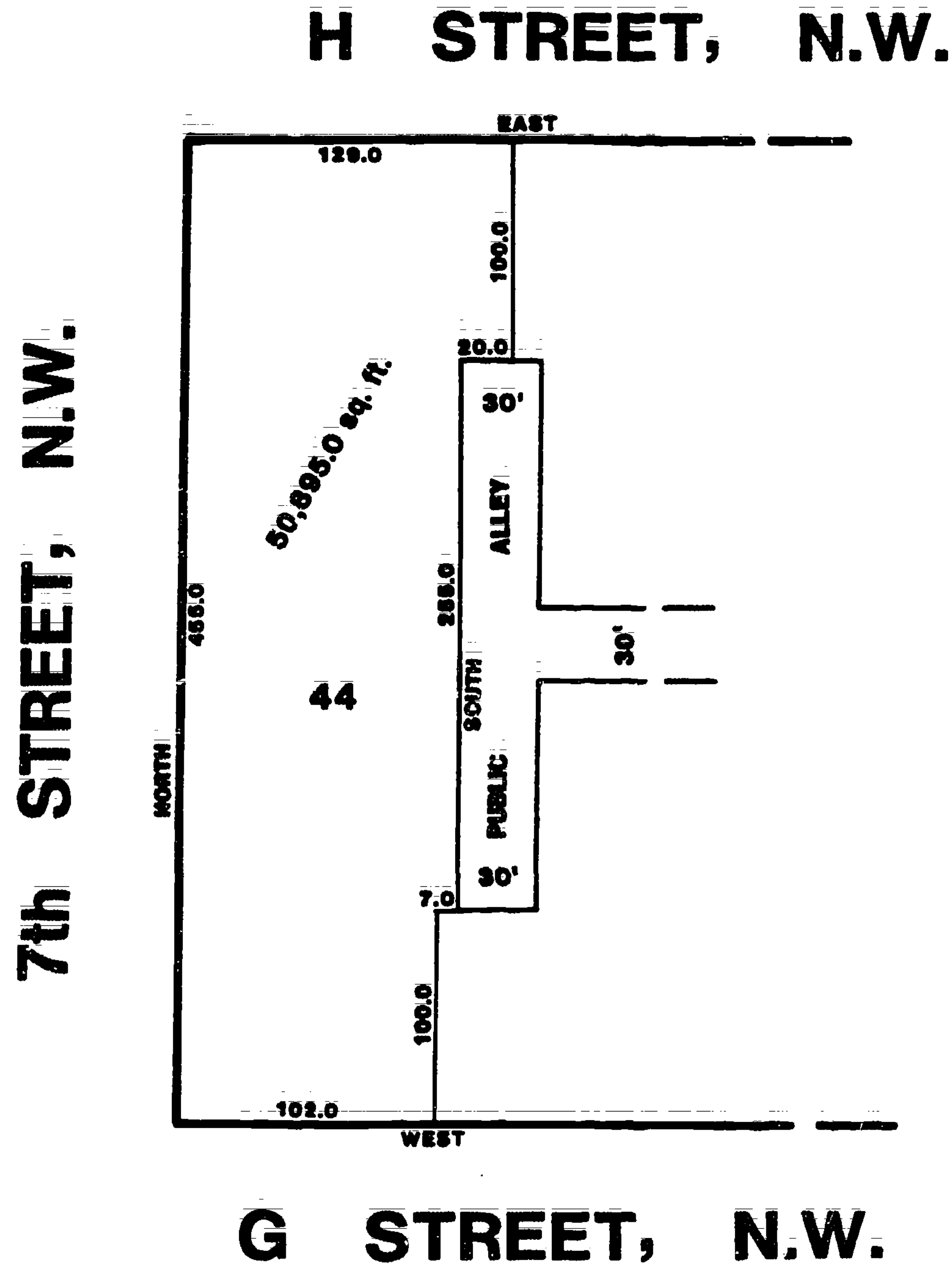


GALLERY PLACE
Traffic Patterns

100 0 100 200

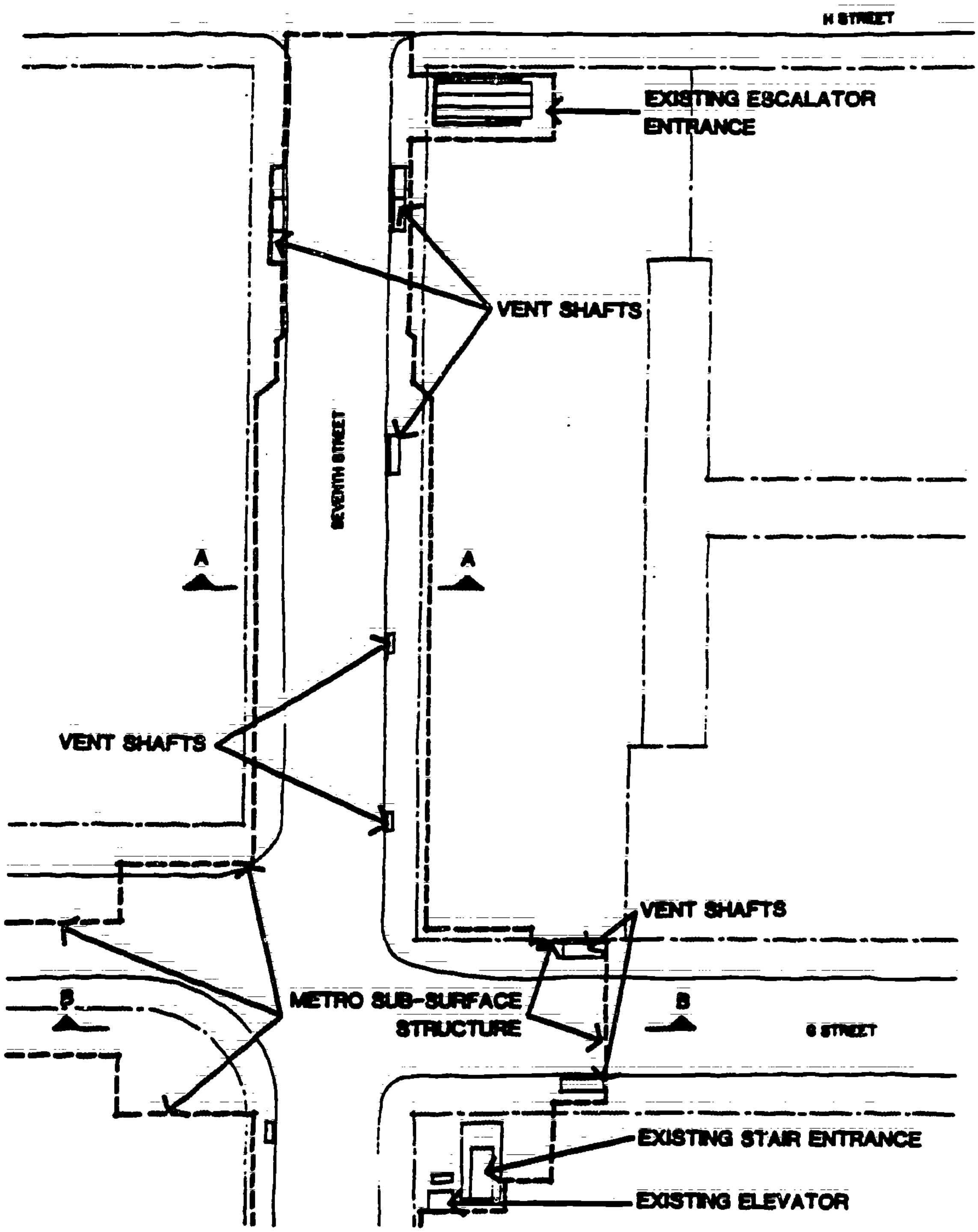
POSSIBLE ACCESS POINT
ACCESS POINT
TRAFFIC FLOW

SUBDIVISION
Square 454



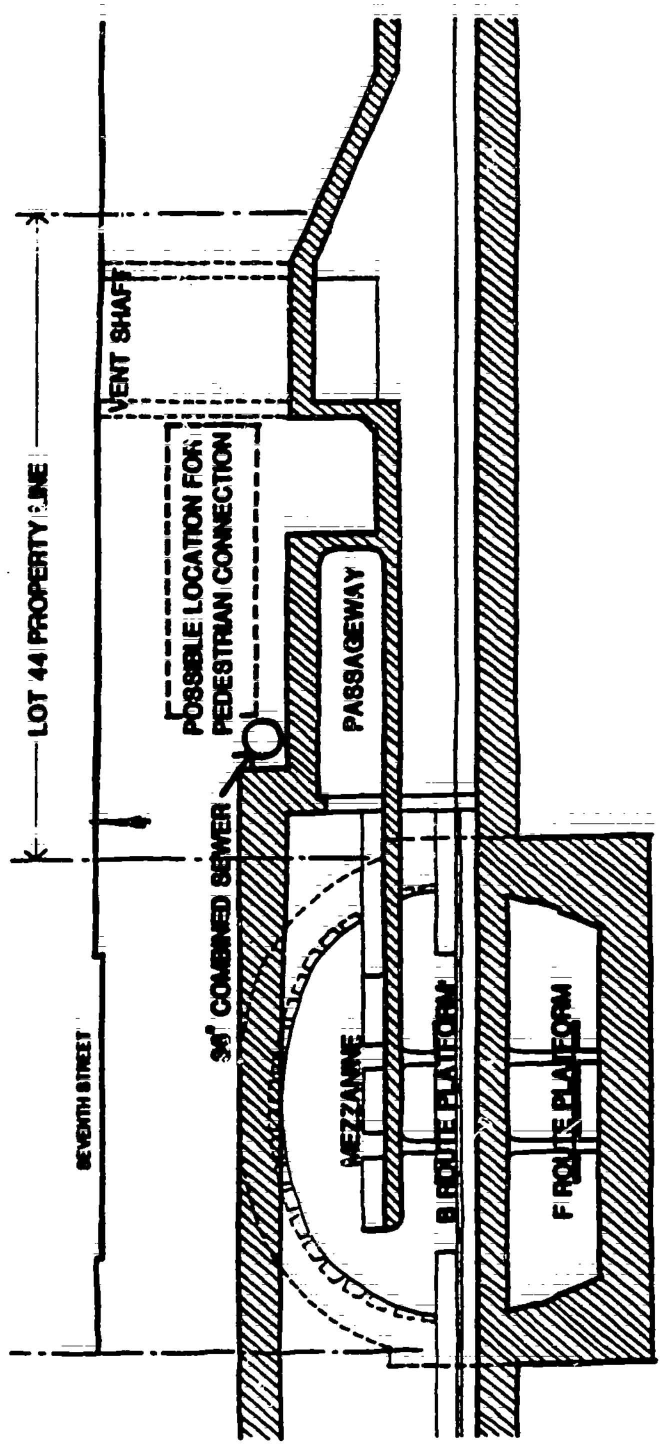
NOT TO SCALE

NOTE: Source from Subdivision Plat, right side, District of Columbia, Office of the Surveyor, Dated June 18, 1979, Book 170, Page 78.



GALLERY PLACE
METRO FACILITIES MAP

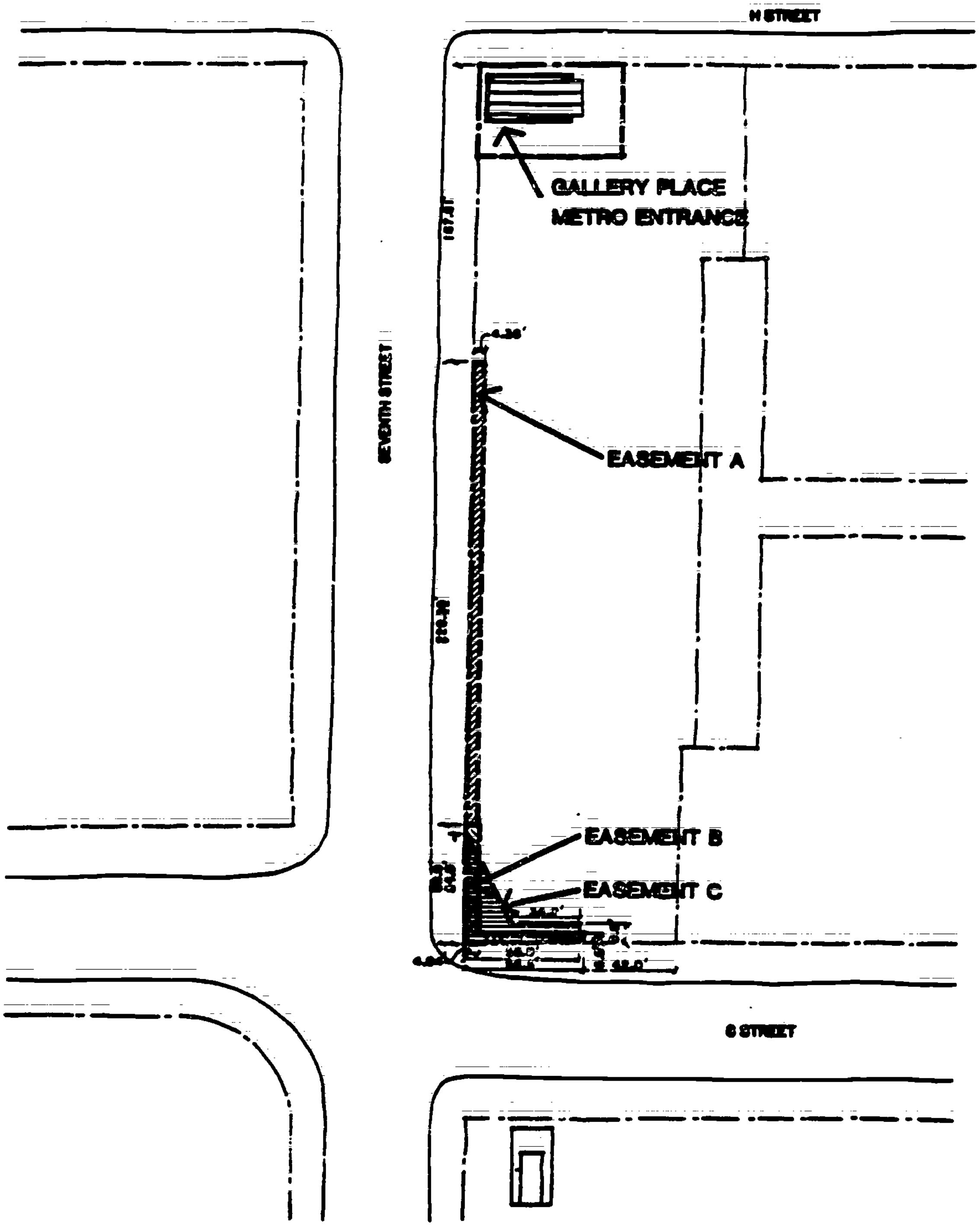
0' 30' 60' 120'



SECTION BB

GALLERY PLACE
SQ. 454 & 455 BELOW GRADE PEDESTRIAN CONNECTION

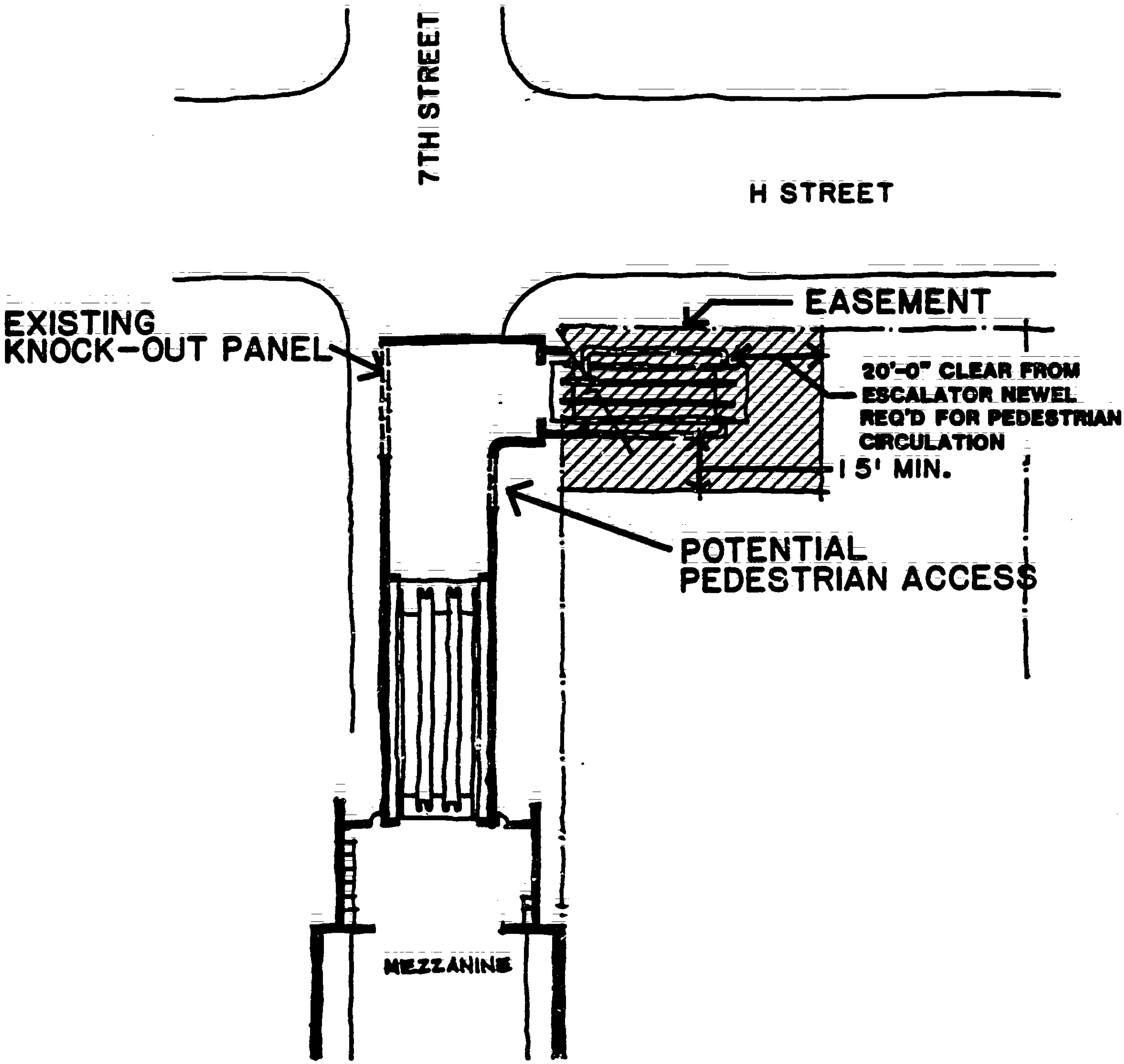
Not To Scale



GALLERY PLACE

EASEMENT MAP

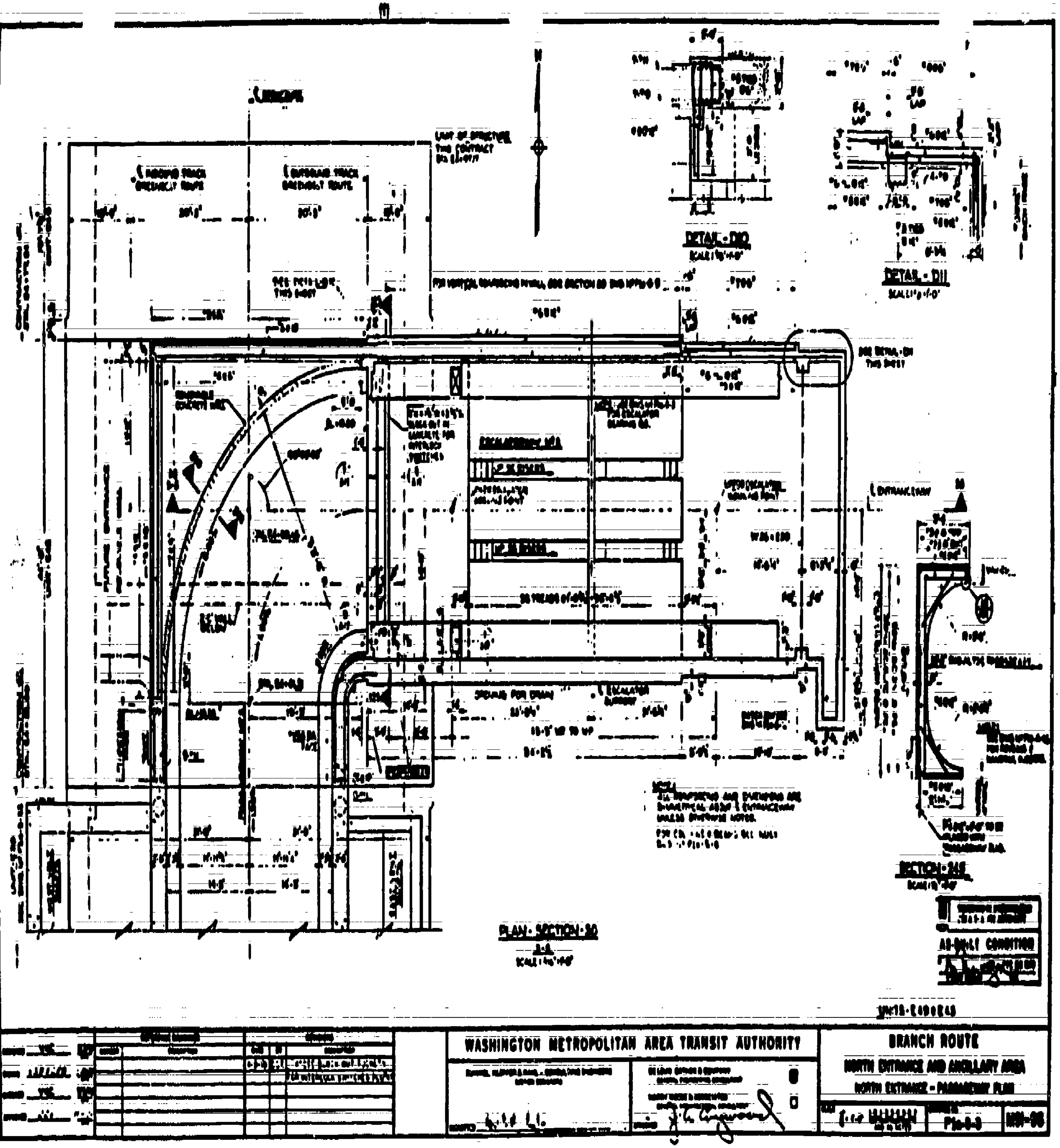
0' 30' 60' 120'



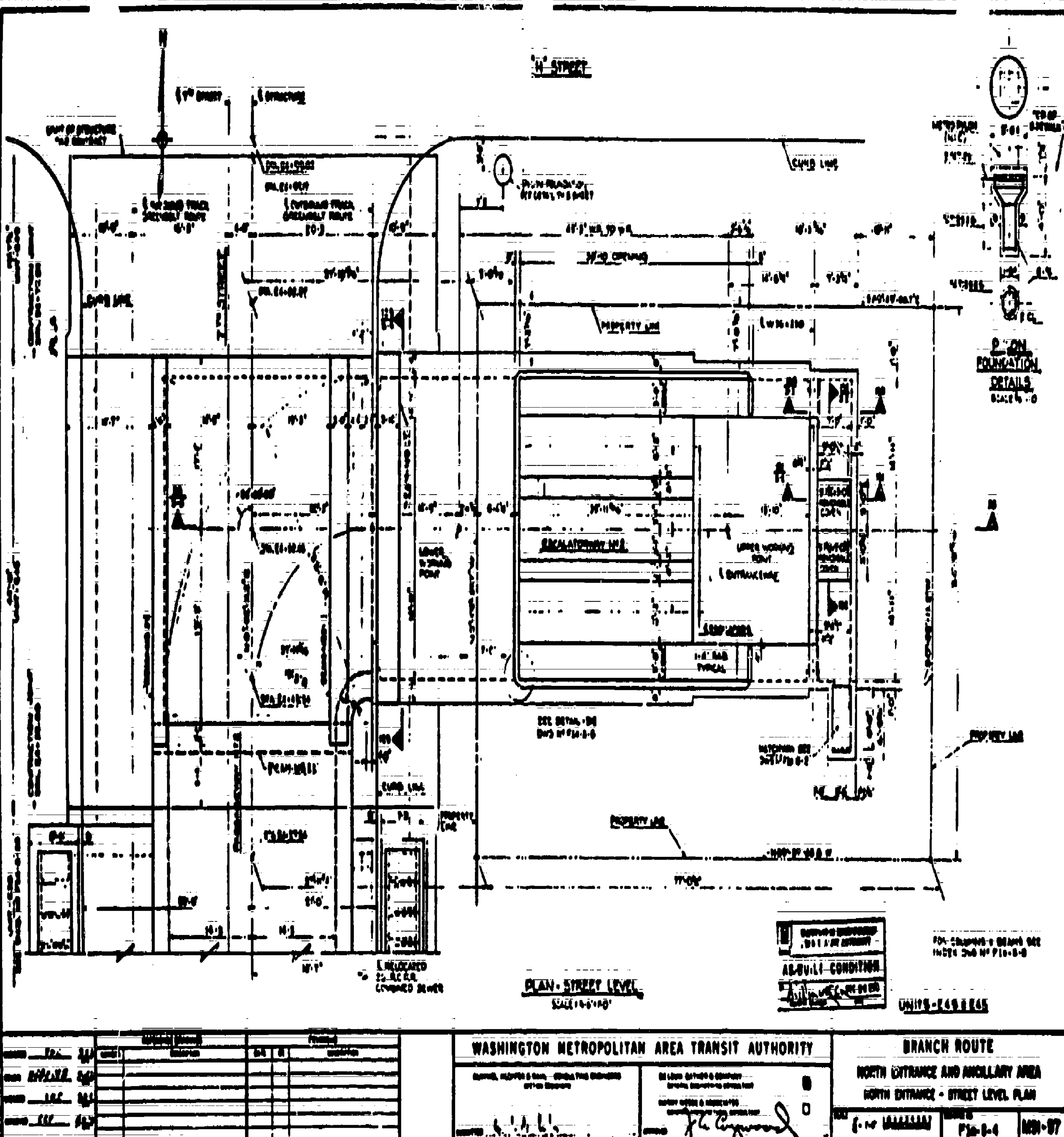
GALLERY PLACE

NORTH ENTRANCE BELOW GRADE ACCESS & ENTRANCE EASEMENT

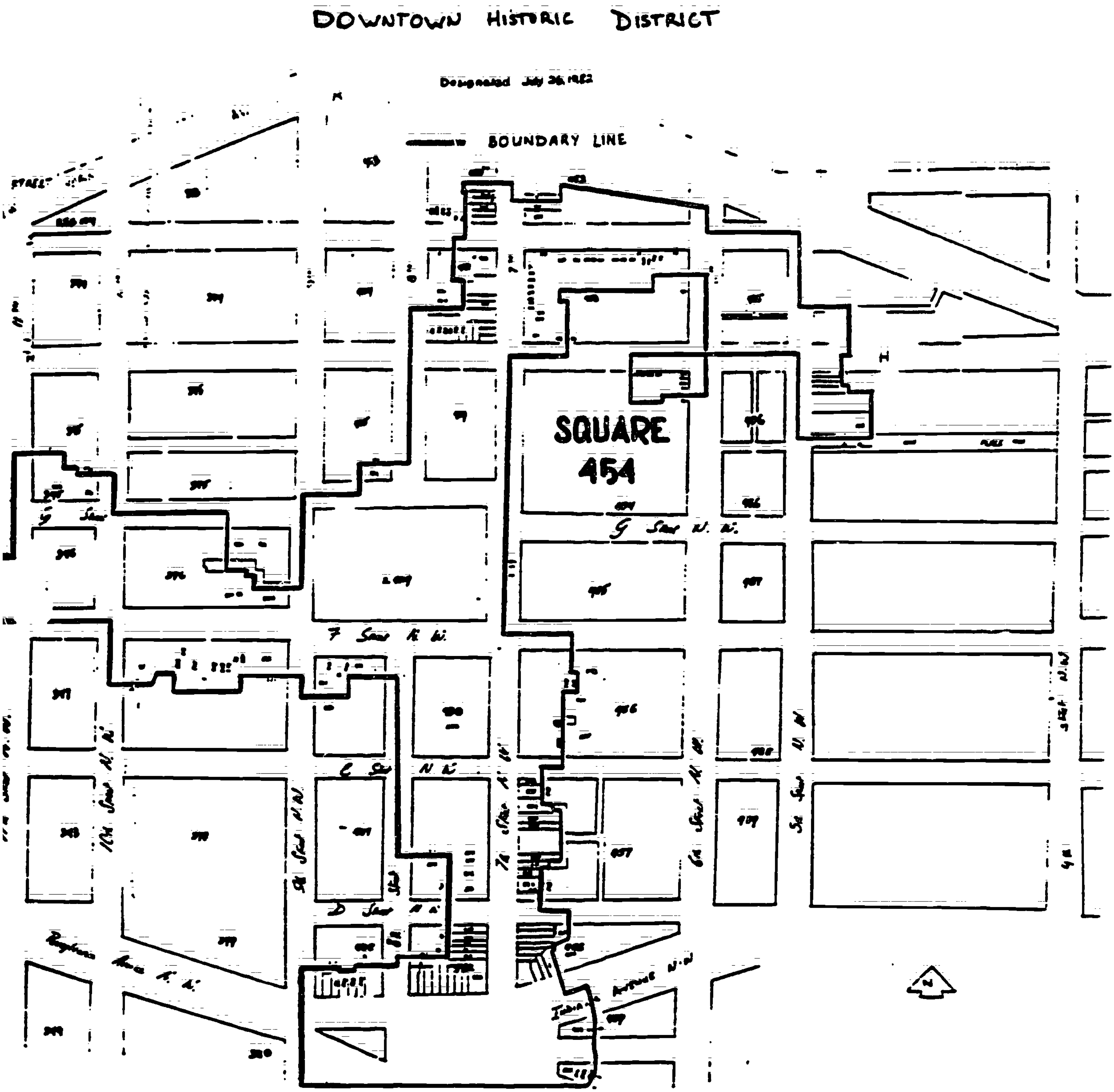
NOT TO SCALE



WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY
BRANCH ROUTE
NORTH ENTRANCE AND ANCILLARY AREA
NORTH ENTRANCE - PASSAGEWAY PLAN
PLAN - SECTION - 30
DETAIL - D10
DETAIL - D11
AS-BUILT CONDITION



BEST COPY AVAILABLE


DOWNTOWN HISTORIC DISTRICT
BOUNDARY LINE
SQUARE 454
G Street N.W.
F Street N.W.
D Street N.W.
Indiana Avenue N.W.

APPENDIX FIVE

PERSONAL FINANCIAL PROFILE QUESTIONNAIRE

Preliminary Questionnaire
(CONFIDENTIAL)

☐ FAMILY INFORMATION

DATE ____________

Client's Name ____________ Date of Birth ____________

Spouse's Name ____________ Date of Birth ____________

Address ____________ Home Phone (____) ____________

____________ Bus. Phone (____) ____________

OCCUPATION / EMPLOYER

Client ____________ ____________

Spouse ____________ ____________

IMMEDIATE FAMILY

Name	Relationship	Age	DEPENDENT? Yes	No

☐ ESTATE INFORMATION

Is there a will? HUSBAND ________ Date ________ WIFE ________ DATE ________

Beneficiaries: HIS WILL Primary: ________ Contingent: ________

HER WILL Primary: ________ ________ Contingent: ________

If spouse is primary beneficiary, does he/she receive full control of all assets owned by the deceased? ________

Are there existing trusts? If so, please describe type, amo ınts and beneficiaries: ________

____

Have any gifts been made from husband to wife or wife to husband? ________

If so, when, in what form and amounts? ________

Charitable interests? ________ Current annual charitable gifts $ ________ At death $ ________

Do you expect any inheritance?

Husband ________ Estimated Amount $ ________ Source ________

Wife ________ Estimated Amount $ ________ Source ________

Are you the beneficiary of any trusts? ________ Describe ________

☐ BUSINESS OWNERSHIP INTERESTS

Your company's name ________

Is it a: Corporation? ________ Partnership? ________ Sole Proprietorship? ________

Is there a stock redemption or buy and sell agreement? ________ Are there any retirement programs, Keogh, pension or profit sharing plans? ________ Describe: ________

☐ EMPLOYMENT BENEFITS

Any stock accumulation plans? ________ Current Value $ ________

Any employee savings plans? ________ Deferred compensation ________ Value $ ________

Any incentive stock options? ________ Number of shares ________ Current Value $ ________

Any non-qualified stock options? ________ Number of shares ________ Current Value $ ________

☐ RETIREMENT PLAN FACTS

Years to retirement? ________ Expected monthly annuity at retirement (pension) $ ________ per month

Expected lump sum available at retirement from profit-sharing, Keogh, thrift plan, etc. $ ________

☐ LIFE INSURANCE AND ANNUITIES

Type (Term, Whole Life)	Face Amount	Cash Value Net of Loans	Annual Premium	Insured/Owner*	Beneficiary
______	$______	$______	$______	___/___	______
______	$______	$______	$______	___/___	______
______	$______	$______	$______	___/___	______
______	$______	$______	$______	___/___	______
TOTAL	$______	$______	$______		

*(H)-Husband, (W)-Wife, (E)-Employer (O)-Other (If (O) specify).

☐ PERSONAL ASSETS [Estimate Only]

	Held by Client	Held by Spouse	Held Jointly	Community Property
Checking Accounts	$______	$______	$______	$______
Savings/CD's	$______	$______	$______	$______
Money Market Funds	$______	$______	$______	$______
Stocks (market value)	$______	$______	$______	$______
Bonds—Corp./Muni.	$______	$______	$______	$______
Notes Receivable	$______	$______	$______	$______
Home Equity (market value less mortgage)	$______	$______	$______	$______
Other Real Estate Equity	$______	$______	$______	$______
Business Interests	$______	$______	$______	$______
Company Retirement Plan(s)	$______	$______	$______	$______
Individual Retirement Accts.	$______	$______	$______	$______
Personal Property	$______	$______	$______	$______
Other Investments	$______	$______	$______	$______
Liabilities Other than Mortgages	$______	$______	$______	$______
	______	______	______	______

☐ INCOME AND EXPENSES [attach copy of most recent tax return]

	LAST YEAR 19____	THIS YEAR 19____	NEXT YEAR 19____
Total Earned Income	$______	$______	$______
Taxable Investment Income	$______	$______	$______
Non-Taxable Income	$______	$______	$______
Long-Term Capital Gains (Total)	$______	$______	$______
Annual Itemized Deductions	$______	$______	$______
Annual Federal Tax	$______	$______	$______
Annual State Tax	$______	$______	$______
Annual Living Expenses	$______	$______	$______
Annual Surplus Funds	$______	$______	$______

Any Foreign Income in the next five years?__________ When__________ Source__________

☐ INVESTMENT DETAILS

STOCKS [Include investment company and mutual fund shares]

No. of Shares	Full Name of Company	TOTAL COST	TOTAL MARKET	ANNUAL INCOME
		$	$	$
		$	$	$
		$	$	$
		$	$	$
		$	$	$
		$	$	$

BONDS

Face Value	(T)-Taxable (NT)-Non-Taxable	Full name of Issuer	TOTAL COST	TOTAL MARKET	ANNUAL INCOME
			$	$	$
			$	$	$
			$	$	$
			$	$	$

REAL ESTATE

Present Value of Home	$	Other Real Estate	$	$
Mortgage Balance	$	Mortgage Balance	$	$
Equity in Home (Value less Mortgage)	$	Equity	$	$

Describe other real estate: ____________________

OTHER INVESTMENTS

	NAME OR TYPE	DATE INVESTED	TOTAL COST	TOTAL MARKET
Real Estate Limited Partnerships			$	$
Oil and Gas Programs			$	$
Precious Metals			$	$
Gems			$	$
Other			$	$

☐ GOALS OR AREAS OF CONCERN

Increased income now________ Income at retirement________ Further building of estate________

Conservation of assets for heirs________ Income tax reduction________ Educate children________

Change jobs________ Sale of business________ Sale of other major assets________

Organize finances________ Reduce debt________ Analyze portfolio________

Additional comments and other pertinent information. Include special questions on estate planning, taxes, financial ideas, etc.:

____

____

C.P.A. ________ Address ________ Phone ________

Attorney ________ Address ________ Phone ________

Account Executive________ Branch________ Phone ________

37640 8/83

APPENDIX SIX

GLOSSARY OF TERMS

GLOSSARY

ABSORPTION RATE-The ability of a given area to utilize new property or vacated existing property by sales or leases.

ADJUSTED BASIS-The original cost of a property minus the total cumulative depreciation deduction.

AMORTIZATION-The periodic repayment of the principal balance plus interest due for money loaned.

ASSETS-Anything of value owned.

BASIS-The basis of a property is its cost as used in computing the taxable gain or loss upon its sale or exchange. The initial basis includes the purchase price or cost to build the property including land, plus closing and other investment costs

BLIND POOL-The sale of partial interest in property which has yet to be acquired or developed.

BREAK-EVEN RATIO-The ratio of operating expenses and debt service to gross potential income. This ratio indicates the amount of occupancy required before a project can meet all cash outlays associated with operations and debt service. Standard break-even occupancy ratios used in underwriting income producing property range from 80 to 85 percent of gross potential income.

BROKER-In real estate, one who is licensed by the state real estate commission to purchase and sell real estate on behalf of others and earn commission income for such services.

CAPITAL-Net worth or the excess of assets over liabilities.

CAPITAL GAIN-The profits realized from the disposition of property at a price higher than the seller's adjusted basis.

CAPITALIZATION RATE-A figure, expressed as a percentage, used to determine the present value of a property's future cash flow. By dividing a property's cash flow by the capitalization the present value of the property is measured.

CARRYING CHARGES-The cost incurred in holding land through the development phase or until disposition can be made. These costs include interest, taxes, maintenance charges and any stand-by assessments that may apply.

CASH FLOW-A property's annual income remaining from operating income after the payment of debt and real estate taxes.

CASH-ON-CASH-The income received during a period, as compared to the amount of money used to acquire an investment is termed cash-on-cash. It is computed by dividing the cash flow before tax by the investment outlay consisting of the down payment and investment costs.

COLLATERAL-Something of value pledged as a security on a debt obligation.

COMMINGLE FUND-A pooled fund of capital contributed by numerous investors for the purpose of purchasing properties and other investments.

CONSTANT PAYMENT-The sum of principal and interest payable to a mortgage lender each month or year.

CONSTRUCTION LOAN-A loan, the funds for which are distributed to the borrower in stages correlated to the progress of a building's construction.

CONTRACTOR-A person or company that agrees to construct for either an agreed upon negotiated fee or cost plus a certain amount or any other financial agreement between owner and contractor.

DEBT SERVICE-The amount of money necessary to meet the periodic payment of principal and interest.

DEBT SERVICE COVERAGE RATIO-The margin between the debt service and the net operating income from a property. It is calculated by dividing net operating income by the mortgage payments made during the year. Generally, the coverage ratio acceptable to the lender is determined by policy established by the particular lending institution based on past loan experience or comparable properties.

DEFAULT RATIO-The default ratio measures the ability of an investment to cover all of the expenses of operations and debt service. It is found by dividing the loan payments and expenses by gross income.

DEPRECIATION-According to the IRS, depreciation is defined as the reasonable allowance for the exhaustion and wear and tear of property. Depreciation is a sum set aside each year so that at the end of a property's useful life, the aggregate of the sums set aside, together with salvage value, will provide an amount equal to the original cost.

DISCOUNT-The difference in the face value of a note and the cash amount paid for it. The purpose of discounting a note is to increase the yield to the lender.

DISPOSITION-The right of a landowner to sell, lease, give away or otherwise dispose of land.

ECONOMIC LIFE-The period, in years or months, during which a property is expected to earn net income or produce rental income.

EMINENT DOMAIN-The right of a government to take private land for a necessary public use for the payment of a just compensation.

ENTREPRENEUR-A person who organizes a business venture.

EQUITY-The value of a property in excess of any indebtedness.

EQUITY PARTICIPATION-A lender's share of the benefits associated with private ownership. Examples of equity participation include the lender's sharing in the increases in a property's cash flow and appreciation.

FEASIBILITY REPORT-A study of a proposed or existing property to determine potential profitability based on a throrough analysis of the market.

FRONT-END FEE-Typically, the charge paid to a lender at the time a loan is initiated.

GAP LOAN-A second mortgage loan made during the construction period. This type of loan fills the "gap" in a developer's financing need during the interval of time between funding of the floor amount of the loan by the permanent lender and the funding of the ceiling amount which is contingent upon the achievement of specified leasing objectives.

GENERAL PARTNER-An individual or corporate entity which is a partner in a general or limited partnership. The liability of the general partner in a limited partnership typically may extend beyond its level of investment.

GROSS INCOME-The amount of annual income earned by a property prior to the deduction of any operating expenses, vacancy allowance, debt service and real estate taxes.

HOLDBACK PROVISION-A holdback is a portion of the permanent financing that is retained by the permanent lender for a specified period of time. This reserve has the effect of forcing applicants to make up the difference by inserting personal funds, adjusting rent schedules, or seeking interim financing.

INCOME PROPERTY-A commercial property that generates an income stream.

INITIAL MARKET RISK-A probability that the initial equity capital will not be recovered.

INTERIM LOAN-A short-term loan made with the expectation of repayment from the proceeds of another loan; often used to describe a construction loan.

INTERNAL RATE OF RETURN-The internal rate of return on a property, also known as the property's yield, correlates the initial investment in the property with the sum of the property's projected cash flow and appreciated value over a specified period of time.

INVESTOR-A person who puts money or other valuables into a business operation as a contributor to the capitalization of that business, with the expectation of making a profit. A lender is not considered an investor because the lender's profit is not normally predicated upon the profits of the business venture.

KICKER-An additional amount paid beyond the terms of an agreement in order to complete a transaction.

LAND ACQUISITION LOAN-A loan for the purpose of acquiring land. Typically, a land acquisition loan is secured by a first lien on the land being acquired and guaranteed by the developer purchasing the land.

LEVERAGE-The use of borrowed funds which have a fixed cost to the borrower as a portion of the purchase price for a property with the expectation of earning a profit on the borrowed funds.

LIMITED LIABILITY-Financial responsibility limited by statute.

LIMITED PARTNER-A passive investor in a limited partnership who does not participate in the administration and management of the partnership and whose liability in the venture is limited to the amount of his/her investment in the venture.

LIQUIDITY-The quality of an investment which allows it to be sold readily for cash without a cut in price.

LOAN CONSTANT-The debt service expressed as a percentage of the loan amount.

MANAGEMENT FEE-Compensation paid to a developer or management firm for services rendered in managing a real estate project.

MARKET VALUE-The highest price that reasonably can be expected to be paid for a property at a given time.

MORTGAGE-A written pledge of property as collateral for a loan.

NET LEASE-A lease where a tenant pays certain operating and maintenance expenses.

NET WORTH-Assets minus liabilities.

NON-RECOURSE LOAN-A loan in which the borrower has no personal liability and the lender's only recourse in the event of a default is the assumption of ownership of the collateral security on the loan.

OFFERING-Syndication (securities) issue for sale to investors

OPERATING EXPENSE RATIO-The operating expense ratio measures the relationship between total operating expenses and effective gross income. It is found by dividing operating expenses by effective gross income. This ratio can then be compared to operating ratios compiled from comparable properties or from published industry data.

OPTION-A right to buy property which is granted by the owner for consideration but without the obligation to buy.

ORIGINATION FEE-A fee paid to a loan correspondent, mortgage broker, or lending institution to cover the expenses associated with loan evaluation, documentation and placement.

PARTNERSHIP AGREEMENT-Agreement between partners setting forth their rights and duties.

PERMANENT LOAN-A loan with a term extending over most of the useful life of a property.

PRESENT VALUE-The value of an investment today computed by measuring the future benefits of the investment and converting these benefits to reflect their worth in terms of current monetary value.

PRIME RATE-The interest rate which is generally regarded as the rate commercial banks will charge their most credit worthy borrowers at a particular time, based upon the bank cost of funds and other market conditions at the time.

PRO FORMA STATEMENT-A projected or estimated financial statement of anticipated future gross income, operating expenses and net operating income for a property, as opposed to statement of actual or current figures.

REAL ESTATE INVESTMENT TRUST-A corporation, organized as a trust and exempt from federal taxation, which is set up to raise a pool of capital for investment in real property and mortgages.

RECOURSE LOAN-A loan which holds the borrower personally liable for the payment of principal and interest according to the schedule stipulated in the loan contract.

REFINANCING-The renewal or renegotiation of an existing mortgage loan on a property or the negotiation of additional mortgage debt either from the original lender or from a new lending source.

RETURN ON INVESTMENT-The correlation, expressed as a percentage, between the amount an investor pays for an asset and the income stream derived from the investment.

RETURN ON EQUITY-The ratio of the after debt-service cash flow of a property to the amount of equity invested in the property; also referred to as cash-on-cash return.

RISK-The probability of failure or loss.

RISK CAPITAL-The funds needed to bring a project concept to the point where institutional lenders and other investors are prepared to invest their financial resources to construct the project.

SALES/LEASEBACK-A real estate transaction in which the owner of a property sells the building and the underlying land to an investor and then leases the land and building back, typically on an absolute net lease basis(i.e. where the tenant pays all operating expenses of the property).

SEC-The Securities and Exchange Commission, a U.S. government regulatory and enforcement agency which supervises investment trading activities and administers securities statutes.

SECOND MORTGAGE-A mortgage placed upon a property subject to a first mortgage. The holder of the second mortgage is subordinate to the holder of the first mortgage, or senior lender, who is entitled to receive debt payments from the borrower before those paid to the second mortgage.

SECURITY-As defined by the Federal Securities Act of 1933, a security is any note, stock, treasury stock, bond debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate or certificate of deposit for a security.

STANDBY COMMITMENT-A promise by a lender to "stand-by" to fund a mortage loan if called upon to do so. Standby commitments most frequently are sought by developers in order to obtain construction financing.

SUBCHAPTER S CORPORATION-A corporation which for tax purposes can qualify and elect to be treated as a parnertship.

SYNDICATE-An association of individuals, usually in the form of a limited partnership organized to carry out a particular business activity.

TAKEOUT COMMITMENT-An obligation by the permanent lender to pay the loan granted by a construction lender when construction is completed.

TAX SHELTER-An investment that provides tax savings or benefits.

YIELD-The rate of return which the total income from an investment bears to the investment.

ZONING LAWS-Regulations authorized under the police powers of the state which prescribes the use of land and the structural design and use for buildings within designated areas of the city.

APPENDIX SEVEN

BIBLIOGRAPHY

DOT MANUAL BIBLIOGRAPHY

Ackerson, Charles B. The Internal Rate of Return In Real Estate Investments. Chicago: American Society of Real Estate Counselors and the American Society of Real Estate Appraisers, 1976.

Alexander, Laurence A. Financing Downtown Action. New York: Downtown Research and Development Center,1975.

Adrian, James L. Business Practice for Construction Management. New York: Elsevier, 1976.

American Institute of Architects. Design-Build-Bid; An Owner's Guide. Washington: 1976.

Anderson Notter Finegold, Incorporated. Recycling Historical Railroad Stations: A Citizen's Manual Boston, Massachusetts, 1978.

Barrie, Donald S. Directions in Managing Constructions; A Critical Look at Present and Future Industry Practices, Problems and Policies. New York: John Wiley & Sons, 1981.

Barrie, Donald S. Professional Construction Management. New York: McGraw-Hill,1978.

Beaton, William R. Real Estate Finance, 2nd ed. Englewood Cliffs, N.J.: Prentice Hall, 1982.

Beck, John. The Small Investment Group: An Effective Equity Building Tool for the Doer. Impact Publishing Company, 1980.

Berman, Daniel, S. How to Put Together a Real Estate Syndicate or Joint Venture. New Jersey: Prentice-Hall, Inc., 1984.

Black, Thomas J. A Directory of Mixed-Use Developers. Washington, D.C.: ULI-the Urban Institute, 1982.

Black, Thomas J., Monna, Michael and O'Connell, Donald. Downtown Office Growth and the Role of Public Transit. Washington, D.C.: ULI-the Urban Land Institute, 1982.

Boykin, James H. Financing Real Estate. Lexington Books, 1979.

Britton, James, ed. Financing Income Producing Real Estate. New York: McGraw-Hill, 1977.

Brueggeman, William B., et al. Real Estate Finance. Richard D. Irwin, Inc., 1981.

Canestaro, James. Real Estate Financial Feasibility Analysis Handbook. Madison, WI: Department of Real Estate and Urban Land Economics, University of Wisconsin at Madison, rev. 1978.

Case, Frederick E. Investing in Real Estate. Englewood Cliffs, N.J.: Prentice-Hall, 1978.

Casey, William J. Real Estate Investment Planning. Englewood Cliffs, N.J.: The Institute for Business Planning, 1980.

Coombs, William E., and Palmer, William J. Construction Accounting and Financial Management. 2d ed. New York: McGraw-Hill, 1977.

Cummings, Jack. Complete Guide to Real Estate Financing. Englewood Cliffs, N.J.: Prentice-Hall, 1978.

Epley, Donald R., et al. Basic Real Estate Finance and Investment. John Wiley & Sons, Inc., 1980.

Federal Register. Participation by Minority Business Enterprises in Department of Transportation Programs, 1983.

Findlay, M. Chapman. Real Estate Portfolio Analysis. Lexington, MA.: Lexington Books, 1983.

Frost, Michael Jr. How To Use Cost Benefit Analysis in Project Appraisal. New York: John Wiley, 1975.

Gladstone Associates. Transportation and Urban Economic Development. Washington, D.C. 1977.

Graaskamp, James A. Guide to Feasibility Analysis. Chicago: Society of Real Estate Appraisers, 1980.

Graaskamp, James A. Fundamental of Real Estate Development. Washington, D.C.: The Urban Land Institute.

Greater Bridgeport Transit System. A Plan for Downtown Transit and Joint Development. Bridgeport, CT., 1980.

Greer, Gaylon E. The Real Estate Investment Decision. Lexington, MA.: Lexington Books, 1979.

Griffin, Charles W. Development Building: The Team Approach. Washington, American Institute of Architects; distributed by Halsted Press, New York, 1972.

Halpin, Daniel W., and Woodhead, Ronald W. Construction Management. New York: John Wiley & Sons, 1980.

Haviland, David. Managing Architectural Projects; Case Studies. Washington: American Institute of Architects, 1981.

Haviland, David. Managing Architectural Projects; the Effective Project Manager. Washington: American Institute of Architects, 1981.

Hohns, H. Murray. Preventing and Solving Construction Contract Disputes. New York: Van Nostrand Reinhold Co., 1979.

Howell Joseph T. Real Estate Development Syndication. Praeger Publishers, 1983.

Jaffe, Austin J., et al. Real Estate Investment Decision Making. Prentice-Hall, 1982.

Kavanagh, Thomas C.; Miller, Frank; and O'Brien, James J. Construction Management; A Professional Approach. New York: McGraw-Hill, 1978.

Lynn, Robert J. Introduction to Estate Planning, 3rd ed., West Publishing, 1983.

Lynn, Theodore S. Real Estate Limited Partnerships. Wiley, 1983.

Mader, Chris. The Dow Jones-Irwin Guide to Real Estate Investing. New York: Dow Jones-Irwin, 1983.

McManan, John. Property Development: Effective Decision Making in Uncertain times. New York: McGraw-Hill, 1976.

Messner, Stephen D., et al. Analyzing Real Estate Opportunities: Market and Feasibility Studies. Chicago: Realtors National Marketing Institute, 1977.

Miller, Daniel A. How to Invest in Real Estate Syndicates. New York: Dow Jones-Irwin, 1980.

National Cooperative Transit Research and Development Program. Impacts of Federal Grant Requirements on Transit Agencies, National Research Council, 1982.

North, Lincoln W. Real Estate Investment Analysis and Valuation. Winnepeg: Sault and Pollard, 1976.

Office of Midtown Planning and Development. Transit Station Area Joint Development Strategies for Implementation - Final Report: 1976 Office of the Mayor, City of New York.

Professional Services Management Journal. Project Management. Newington, Conn.: 1978.

Public Technology, Incorporated. Joint Development Marketplace Washington, D.C., 1978.

Pyhr, Stephan A., et al. Real Estate Investment: Strategy, Analysis, Decisions. John Wiley & Sons, 1982.

Redstone, Louis G. The New Downtowns: Rebuilding Business Districts. New York: McGraw-Hill, 1976.

Resources Inc. A Study to Identify Effective, Efficient, and Transferable Minority Business Enterprise (MBE) Strategies Within a Multi-Model Transit System , 1982.

Rice Center for Community Design and Research. Joint Development Report Houston, Texas, 1979.

Rice Center for Community Design and Research. Value Capture and Joint Development Applications: Chicago/Louisville/Los Angeles Office of University Research, Houston, Texas and Washington, D.C., 1977.

Royer, King. The Construction Manager in the 80's. Englewood Cliffs, N.J.: Prentice-Hall, 1981.

Sassone, Peter G. and Schaeffer, William A. Cost-Benefit Analysis: A Handbook. New York: Academic Press, 1978.

Snyder, Earl A. Before You Invest: Questions and Answers on Real Estate. Reston, VA.: Reston Publishing Company, 1979.

Teets, Robert L. Profitable Management for the Subcontractor. New York: McGraw-Hill, 1976.

Urban Land Institute. Development Review and Outlook 1983-1984. Washington, D.C., 1983.

Urban Land Institute. Dollars & Cents of Shopping Centers: 1984. Washington, D.C., 1984

Urban Land Institute. Downtown Development Handbook. By Ralph J. Basile, J. Thomas Black, Douglas R. Porter and Lyndia Lowy. Washington, D.C.: 1980.

Urban Land Institute. Hotel/Motel Development. Washington, D.C., 1984.

Urban Land Institute. Rental Housing. Washington, D.C., 1984.

Urban Land Institute and Gladstone Associates. Joint Development: Making the Real Estate-Transit Connection. Washington, D.C.: Urban Land Institute, 1979.

Urban Land Institute. Public Transit and Downtown Development Washington, D.C., 1979.

U.S. Department of Transportation. Joint Development: A Handbook for Local Government Officials. Washington, D.C.: Public Technologies, Inc., 1983.

U.S. Department of Transportation. Joint Public/Private Initiatives Transit Finance Fact Sheet, Washington, D.C., 1982.

U.S. Department of Transportation. Planning and Designing a Transit-Center-Based Transit System: Guidelines and Examples from Case Studies in 22 Cities 1980.

U.S. Department of Transportation. Urban Mass Transportation Act of 1964, as Amended through May 1983 - and Related Laws .

Wiley, Robert J. Real Estate Accounting and Mathematics Handbook. New York: John Wiley and Sons, 1980.

Witherspoon, Robert. Codevelopment: City Rebuilding by Business and Government. Washington, D.C.: Urban Land Institute, 1982.

Witherspoon, Robert E., Abbet, Jon P., and Gladstone, Robert M. Mixed-Use Development: New Ways of Land Use. Washington, D.C.: ULI- the Urban Land Institute, 1976.

Wilburn, Michael D. and Gladstone, Robert M. Utilizing Development Profits in Large-Scale Real Estate Projects. Washington, D.C.: ULI-the Urban Land Institute, 1972.

☆U.S. GOVERNMENT PRINTING OFFICE: 1986-491-810/20711

NOTICE

This document is disseminated under the sponsorship of the Department of Transportation in the interest of information exchange. The United States Government assumes no liability for its contents or use thereof.

The United States Government does not endorse manufacturers or products. Trade names appear in the document only because they are essential to the content of the report.

This report is being distributed through the U.S. Department of Transportation's Technology Sharing Program.

DOT-I-86-14